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NO.

in the Supreme Court of the United States

October Term, 1985

CARL H. HOFFMAN and
CARL H. HOFFMAN, P.A.,

Petitioners,

vs.

DAVID SYLVA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

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QUESTIONS PRESENTED

I

MAY A COURT OF APPEALS, INVOKING ITS "SUPERVISORY POWERS" MAKE DETERMINATIONS OF FACTS NOT TRIED IN THE DISTRICT COURT AND THEN DEPRIVE COUNSEL AND HIS CLASS ACTION CLIENTS OF THE PROPERTY DISTRIBUTED TO THEM BY ORDERS OF THE DISTRICT COURT? DOES SUCH ACTION RESULT IN A DEPRIVATION OF PROPERTY WITHOUT DUE PROCESS OF LAW AND A USURPATION OF THE DISTRICT COURT'S FACT FINDING FUNCTION?

II

MAY A COURT OF APPEALS, INVOKING ITS "SUPERVISORY POWERS" MAKE DETERMINATIONS OF FACTS NOT TRIED IN THE DISTRICT COURT AND THEN SUMMARILY TERMINATE *INSTANTER* A LONG STANDING LAWYER CLIENT RELATIONSHIP, THUS PRECLUDING COUNSEL FROM ANY FURTHER REPRESENTATIVE ROLE IN THE CASE, AND PRECLUDING HIS CLIENTS FROM EXERCISING THEIR RIGHTS TO PETITION FOR REHEARING OR CERTIORARI? DOES SUCH ACTION RESULT IN A DEPRIVATION OF PROPERTY OR LIBERTY WITHOUT DUE PROCESS OF LAW AND A USURPATION OF THE DISTRICT COURT'S FACT FINDING FUNCTION?

III

MAY THE EXTRAORDINARY REMEDY OF MANDAMUS BE USED BY A COURT OF APPEALS TO REVIEW A DISTRICT COURT'S ALLEGED ABUSE OF DISCRETION IN INTERPRETING ITS DUTIES WITH REGARD TO SPECIFIC ISSUES PREVIOUSLY REMANDED TO IT BY THE COURT OF APPEALS?

THE PARTIES TO THE PROCEEDING IN THE COURT BELOW

The parties to the proceedings in the Court of Appeals were Peter Piambino and Joseph F. Kucklick, class representatives of all persons who purchased or invested in direct distributorships of Bestline Corporation during the period of March 7, 1970 through August 10, 1973.

The defendants below were Bestline Corporation, a California corporation, which is the parent corporation of a wholly owned subsidiary, Bestline Products, Inc., and William E. Bailey and David L. Eastis.

Another party below was David R. Sylva, the trustee of a California Restitutionary Fund.

Carl H. Hoffman and Carl H. Hoffman P.A. were not parties below. Carl Hoffman was one of the two Lead Counsel for plaintiffs. The decision below removed him and co-lead counsel from that role, immediately terminated Hoffman's lawyer-client relationship with the plaintiff class, and required that he immediately repay the fees and costs he had been awarded seven years earlier. Thus he, and his professional association which received those monies have now become parties to this litigation.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i, ii
THE PARTIES TO THE PROCEEDINGS IN THE COURT BELOW	iii
TABLE OF AUTHORITIES	vi, vii, viii
OPINION BELOW	1
JURISDICTION	2
CONSTITUTIONAL PROVISION INVOLVED	2
STATEMENT OF THE CASE	2
A. Piambino I	4
B. Piambino II	7
REASONS FOR GRANTING CERTIORARI	13
I	
THE DECISION BELOW PRESENTS IMPORTANT BUT UNANSWERED QUESTIONS OF AN APPELLATE COURT'S AUTHORITY TO MAKE *DE NOVO* FACTUAL FINDINGS, AND CONFLICTS WITH THE DECISIONS OF THIS COURT WHICH MAKE FACTUAL DETERMINATIONS THE PROVINCE OF THE UNITED STATES DISTRICT COURTS	13

TABLE OF CONTENTS (Continued)

Page

II

THE DECISION BELOW, BY ENGAGING IN APPELLATE FACT FINDING WHICH PRETERMITTED THE OPPORTUNITY FOR AN EVIDENTIARY INQUIRY CONFLICTS WITH THE DUE PROCESS DECISIONS OF THIS COURT REQUIRING A MEANINGFUL OPPORTUNITY TO BE HEARD PRIOR TO THE TAKING OF PROTECTED PROPERTY AND LIBERTY INTERESTS. 15

III

THE DECISION BELOW PRESENTS IMPORTANT BUT UNANSWERED QUESTIONS REGARDING THE USE OF MANDAMUS AND THE SUPERVISORY POWERS DOCTRINE AND CONFLICTS WITH THE DECISIONS OF THIS COURT AUTHORIZING THE USE OF THOSE EXTRAORDINARY REMEDIES AND POWERS. 17

A. Mandamus 17

B. Supervisory Powers 19

CONCLUSION 21

TABLE OF AUTHORITIES

Page

Anderson v. Bessemer,
____ U.S. ____, 105 S.Ct. 1504 (1985) 13

Bell v. Burson,
402 U.S. 535 (1971) 16

Board of Regents v. Roth,
408 U.S. 564 (1972) 16

Cossette v. Country Style Donuts, Inc.,
647 F.2d 526 (5th Cir. 1981) 13

Craig v. Boren,
429 U.S. 190 (1976) 3

Fuentes v. Shevin,
407 U.S. 67 (1972) 16

Goldberg v. Kelly,
397 U.S. 254 (1970) 16

Goland v. Central Intelligence Agency,
607 F.2d 339 (D.C. Cir. 1979) 13

Klapprott v. United States,
335 U.S. 601 (1949) 19

Lassiter v. Department of Social Services of Durham County,
452 U.S. 18 (1981) 20

McNabb v. United States,
318 U.S. 332 (1943) 19

TABLE OF AUTHORITIES (Continued)

Page

Oregon v. Kennedy,
456 U.S. 667 (1982) 14

Photovest Corp. v. Fotomat Corp.,
606 F.2d 704 (7th Cir. 1979) 19

Piambino v. Bailey,
610 F.2d 1306, (5th Cir. 1980) ..... *passim*

Piambino v. Bailey,
757 F.2d 1112, (11th Cir. 1985) ..... *passim*

Sniadach v. Family Finance Corporation,
395 U.S. 337 (1969) 16

United States v. Dante,
739 F.2d 547 (11th Cir. 1984) 14

United States v. Wodtke,
711 F.2d 86 (8th Cir. 1983) 14

Vendo Company v. Lektro-Vend Corporation,
434 U.S. 424 (1978) 19

Weisberg v. Department of Justice,
705 F.2d 1344 (D.C. Cir. 1983) 13

Will v. United States,
389 U.S. 90 (1967) 18

Wisconsin v. Constantineau,
400 U.S. 433 (1971) 16

Zenith Radio Corp. v. Hazeltine Research, Inc.,
395 U.S. 100 (1969) 13

OTHER AUTHORITIES

	Page
28 U.S.C. 1254(1)	2
28 U.S.C. 1291 (1982)	7
28 U.S.C. 1651 (1982)	7
28 U.S.C. 2101(c)	2
The Supervisory Power of the Federal Courts, 76 Harv.L.Rev. 1656 (1963)	20

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OPINION BELOW

The opinion of the United States Court of Appeals for the Eleventh Circuit is reported at 757 F.2d 1112 (11th Cir. 1985). A copy of the opinion and the Order Denying Rehearing and Rehearing *en banc* appear in

the Appendix to this Petition. A copy of a former opinion of the Eleventh Circuit in this case which was reported at 610 F.2d 1306 (5th Cir.), *cert. denied*, 449 U.S. 1011 (1980), is also reproduced in the Appendix.

JURISDICTION

The decision of the Court of Appeals was rendered on March 18, 1985. A timely Petition for Rehearing and Suggestion for Rehearing *En Banc* was denied on May 15, 1985. This Petition has been filed within 90 days of that date pursuant to 28 U.S.C. §2101(c). The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

CONSTITUTIONAL PROVISION INVOLVED

AMENDMENT V

No person shall . . . be deprived of life, liberty, or property, without due process of law.

STATEMENT OF THE CASE

Carl H. Hoffman and Carl H. Hoffman, P.A. seek certiorari to review a decision of the United States Court of Appeals for the Eleventh Circuit which *sua sponte* and summarily stripped Carl H. Hoffman of his class action clients, denied those three thousand clients a right to be heard on rehearing or certiorari, and ordered that those clients, and Hoffman, repay *instanter*, with accrued interest, the monies which had been disbursed to them in 1977 pursuant to a United States District Court order approving a several million dollar class

action settlement against various perpetrators of an alleged securities fraud.[1]

That extraordinary decision, *Piambino v. Bailey*, 757 F.2d 1112 (11th Cir.1985) (A 65-142), (*Piambino II*), cast in the form of mandamus, found, as a matter of fact, that

> . . . the lawyers who have been representing the plaintiff class have a conflict of interest with the minority segment of the class. They have used this conflict of interest to benefit themselves and the majority of the class members since the case began.
>
> 757 F.2d at 1115; A 65.

In arriving at its finding of conflict and decision to "terminate" the existing lawyer client relationship, and compel the return of approved fees and settlement

---

[1]"The termination of the lawyer-client relationship became effective as of the date this opinion is published." 757 F.2d 1147; A 141. Thus the plaintiff class was denied any opportunity to petition the court of appeals for rehearing. A motion to extend the time for rehearing until 30 days after new counsel was appointed for the class was denied (A 143). The harshness of that ruling is underscored by the fact that the Court of Appeals, convinced of a conflict, allowed Lead Counsel to argue plaintiffs' case, and then denied their losing clients any right to post-decision review.

As of the date of the filing of this Petition, no new counsel has been appointed to represent the affected class plaintiffs. Petitioners cannot represent them as a result of the decision below. However, we believe that the doctrine of *jus tertii* standing permits this Court to consider the class plaintiffs' injuries. The petitioners have plainly suffered an "injury in fact", and are entitled to assert "those concomitant rights of third parties that would be 'diluted or adversely affected' should [their] constitutional challenge fail and the [decision below] remain in force." *Craig v. Boren*, 429 U.S. 190,194-95 (1976).

proceeds, the Court below engaged in fact finding without the benefit of a district court trial on the issue.

This Petition focuses upon the important questions presented by the appellate court usurpation of a power traditionally left to the trial courts.

The long history of this case is not wholly pertinent to the specific questions presented here, but it must be told. Therefore we begin with *Piambino I*, *Piambino v. Bailey*, 610 F.2d 1306 (5th Cir.1980).

A. *Piambino I*

In *Piambino* v. *Bailey*, 610 F.2d 1306 (5th Cir. 1980), the Fifth Circuit reversed a District Court decision granting summary judgment and other relief in favor of a class of plaintiffs who had been the victim of a nationwide pyramid scheme bilking them out of millions of dollars.

Bestline Products, Inc., a California corporation, was the culprit, along with its principals, William E. Bailey and Jerry G. Brassfield. The California Attorney General successfully pursued state law remedies and ultimately created a restitutionary trust fund (the California fund) for the benefit of certain categories of persons harmed by the Bestline scheme *Piambino I*, 610 F.2d at 1313; A 13, 14.

Shortly thereafter a federal class action alleging, *inter alia*, violations of the Securities Exchange Acts of 1933 and 1934, was filed in the United States District Court for the Southern District of Florida. That Court issued an injunction enjoining Bestline from complying with the California judgment. In addition, a $1,036,000 sum which had been deposited into the registry of a

federal court in California as a result of Bailey's payment of a judgment secured by the Federal Trade Commission was transferred to the United States District Court for the Southern District of Florida for distribution there to the plaintiff class. 610 F.2d at 1315; A 17.

By enjoining Bestline from complying with the California judgment, the beneficiaries of the California fund were denied Bestline's continuing contributions to the California fund. David Sylva, Compliance Officer of the California restitutionary fund sought to intervene in the Florida case to protect the California fund. The District Court denied his motion. 610 F.2d at 1320; A 30.

Subsequently, with the District Court's approval, two separate settlements occurred: first, Bailey settled and then Bestline and 27 individual defendants agreed to pay, in various forms, approximately $2,300,000. 610 F.2d at 1327; A 46. The District Court also approved an attorneys' fee of $750,000, and expenses of $50,000.

Sylva's appeal challenged all of the District Court's rulings and its approval of the Bestline settlement. However, Sylva did not seek an appellate stay of the District Court's order permitting disbursement of the Bestline funds. Sylva ultimately prevailed, and the Fifth Circuit concluded its lengthy discussion this way:

> We summarize our holdings in this case as follows:
>
> 1. Summary judgment should not have been entered.
>
> 2. Sylva was entitled to intervention as a matter of right.

3. The attorneys' fees as proposed in the Bestline settlement should not have been approved as presented.

4. The entry of an injunction against enforcement of the judgment of the California Superior Court is reversed.

5. The order entering final judgment as to Bestline and 27 individual defendants is vacated.

610 F.2d at 1334; A 61, 62.

The Court was "convinced that the District Court fell into serious error when it approved the attorneys' fees proposed in the Bestline settlement", 610 F.2d at 1328; A 49, and refused the request of the settling parties to "independently evaluate the reasonableness of those fees", saying:

> This is not our normal practice; however, since the District Court is infinitely better situated to conduct the factual inquiry necessary under *Johnson* [*v. Georgia Highway Express*, 488 F.2d 715 (5th Cir.1974) . . .
>
> *Id.*, 610 F.2d at 1329; A 49, 50.

Thus, *Piambino I* did not compel the District Court to secure return of the already paid fees and expenses. Nor did *Piambino I*, by setting aside the Bestline settlement, compel the injured plaintiffs to return the monies they had received to the Court. Finally, *Piambino I* did not compel the District Court to remove Lead Counsel from the case.

Piambino II did compel the return of the attorneys' fees; did compel the injured plaintiffs to return the monies disbursed to them; and did compel the removal of Lead Counsel from the case. It did so by utilizing mandamus, claiming that the failure of the District Court to order those results violated the "implicit" holdings of *Piambino I:* "[I]t [the District Court] is bound to follow the appellate court's holdings, both express and implied." *Piambino II,* 757 F.2d at 1119; A 77.

B. *Piambino II*

On remand from Piambino I the District Court

> . . . acting *sua sponte,* issued an order on our mandate. The order *followed the letter of the mandate* with one exception: it refused to grant Sylva intervention as a party plaintiff.
>
> 757 F.2d 1118; A 74 (emphasis supplied)

Sylva also asked the District Court to "order plaintiffs and Lead Counsel to transfer to the California Fund the monies they had received as a result of the settlement, contending that such action was mandated." 757 F.2d at 1118; A 74. Upon the District Court's denial of Sylva's intervention and transfer motion, Sylva appealed.

The Eleventh Circuit "treat(ed) Sylva's appeal as a petition for writ of mandamus pursuant to 28 U.S.C §1651 (1982) because there is some question whether the District Court's action in failing to follow our mandate constitutes a final judgment reviewable under 28 U.S.C. §1291 (1982)." 757 F.2d at 1115 n.2; A 66. Sylva did not see mandamus as the proper remedy, characterizing

the case as an appeal "to review the District Court's *abuse of discretion* in refusing to grant restitution of funds seized pursuant to a subsequently reversed order." Brief of Appellant Intervenor David R. Sylva, Compliance Officer of the California Restitutionary Fund, at 2 (emphasis supplied).

The Court below traced the history of the litigation and then concluded "that the *Piambino I* panel properly intended that the monies disbursed in connection with the Bestline settlement be restored to the registry of the district court", 757 F.2d at 1137; A 119.

> The panel no doubt would have expressed this view had Lead Counsel informed it in oral argument, or later in their petition for rehearing that they intended to preserve their settlement and notwithstanding the panel's decision, would resist any effort to make them, or their clients, return the proceeds thereof to the district court's registry. Moreover, the panel would have included among its explicit holdings the instruction that the district court forthwith order Lead Counsel and the plaintiffs who had participated in the settlement to deposit the funds they had received, with interest, in the court's registry. Finally, *the panel would have instructed the district court to determine whether Lead Counsel's financial stake in the case was such that Lead Counsel could no longer represent the interests of the Majority Group.*
>
> 757 F.2d 1139 ; A 123 (emphasis supplied.)

The *Piambino II* panel, having opined the "intent" of the *Piambino I* panel, exercised its "power to supervise the district courts" and "terminated" Lead Counsel's representation of the plaintiff class.[2] 757 F.2d 1146; A 140. Thus, despite its view that the *Piambino I*, panel "would have instructed the district court to determine [if there was a conflict]", the *Piambino II* panel, without providing notice and an opportunity to be heard, made that determination itself. As a result, thousands of beneficiaries of Lead Counsels' settlement were stripped of their right to counsel, and they, and Lead Counsel, were ordered to immediately repay the monies disbursed to them years before by court order. The *Piambino II* Court summarized the pertinent part of its holding this way:

> First, David R. Sylva, as an intervenor in behalf of the Minority Group, is a party plaintiff in this case. The district court shall recognize him as such and shall certify the Minority Group as a plaintiff-subclass upon receipt of our mandate.
>
> Second, Lead Counsel shall pay into the registry of the district court the attorney's fee and reimbursed litigation expenses they received in connection with the Bestline settlement, with interest at the legal rate from the date of this court's issuance of the mandate in *Piambino I*. Immediately upon its receipt of our mandate, the district court shall *instanter*,

---

[2]Lead Counsel had, in response to *Piambino I*, limited their representation to the majority group—the non beneficiaries of the California Fund.

without a hearing, issue an order directing Lead Counsel to deposit such amount in the court's registry within thirty days of the date of its order. The order shall recite that Lead Counsel's failure to comply therewith shall subject them to the district court's contempt power.

Third, each of the class plaintiffs who received any of the proceeds of the Bestline settlement shall pay the total amount of such proceeds into the registry of the district court, with interest from the date the clerk of the court disbursed such proceeds to them. Immediately upon its receipt of our mandate, the district court shall *instanter*, without a hearing, issue an order directing that each such plaintiff deposit the amount of the proceeds he received in the court's registry within thirty days of the date of its order. The order shall recite that failure of such plaintiff to comply therewith shall subject him to the district court's contempt power.

* * *

Seventh, Lead Counsel are barred from appearing as counsel for any party in this case, save themselves, effective as of the date this opinion is published.

Eighth, on receipt of our mandate, the district court shall appoint counsel to represent the members of the plaintiff-class comprising the Majority Group, in the event such class members are unable to employ counsel.

These holdings with regard to Lead Counsel and their conflict were made without distinguishing between the petitioner and James H. Joseph, a Pittsburgh attorney who handled the California litigation and who was co-counsel in the Florida proceedings.

The underlying factual bases for these holdings were the Court of Appeals findings that:

> (a) The Bestline settlement was accomplished at the expense of the California class *primarily to provide Lead Counsel an attorneys' fee;*
>
> (b) Lead Counsel *knew* that Sylva's appeal was meritorious;
>
> (c) Lead Counsel *knew* that the June 30, 1976 injunction . . . was entirely baseless;
>
> (d) Lead Counsel *could not have been surprised when the Piambino I* panel rejected [the injunctive relief];
>
> (3) Lead Counsel *knew* that if the panel concluded that Sylva had a right to intervene, their settlement would fall.
>
> *Piambino II*, 757 F.2d 1140, 1141; A 127, 128. (emphasis supplied)

Those findings form the foundation of the conflict and the punitive sanctions imposed upon the petitioners and the class members who are now without counsel in this court, and who must return funds paid to them *via* a valid order of the United States District Court for the Southern District of Florida.

Those appellate court findings of fact also form the foundation of this Petition for Writ of Certiorari

which raises questions regarding the power and authority of an appellate court to dispense with the opportunity to present testimony on issues of knowledge intent and conflict of interest, and instead usurp the fact finding function historically assigned to the United States District Courts.

REASONS FOR GRANTING CERTIORARI

I

THE DECISION BELOW PRESENTS IMPORTANT BUT UNANSWERED QUESTIONS OF AN APPELLATE COURT'S AUTHORITY TO MAKE *DE NOVO* FACTUAL FINDINGS, AND CONFLICTS WITH THE DECISIONS OF THIS COURT WHICH MAKE FACTUAL DETERMINATIONS THE PROVINCE OF THE UNITED STATES DISTRICT COURTS.

The opinion below, insofar as it found a conflict of interest and terminated the lawyer client relationship between Carl H. Hoffman and his class clients, is premised upon the court's belief that Lead Counsel knowingly and intentionally manipulated this case "to benefit themselves and the majority of the class members since the case began." 757 F.2d at 1115; A 65.

Whether or not a conflict exists is a question of fact. *Cossette v. Country Style Donuts, Inc.*, 647 F.2d 526, 530 (5th Cir. 1981). Questions of fact are for trial courts, not appellate courts.

In *Anderson v. Bessemer*, ____ U.S. ____, 105 S.Ct. 1504, 1512 (1985), this Court, quoting *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 123 (1969) cautioned: "[A]ppellate courts must constantly have in mind that their function is not to decide factual issues *de novo*." The Courts of Appeals have recognized that "An appellate court has no fact finding function." *Goland v. Central Intelligence Agency*, 607 F.2d 339,371 (D.C. Cir.1979); *Weisberg v. Department of Justice*, 705 F.2d 1344 (D.C. Cir.1983).

Where, as here, the alleged intent of the lawyer was the critical factor prompting the panel to find conflict, a trial court was the proper forum for making that determination.

This Court, addressing intent in the context of a prosecutor's desire to cause a mistrial, has unequivocally described the inquiry as a factual one.

> [A] standard that examines the intent of the prosecutor, though certainly not free from practical difficulties, is a manageable standard to apply. It merely calls for the court to make a finding of fact. Inferring the existence or non-existence of intent from objective facts and circumstances is a familiar process in our criminal justice system.

Oregon v. Kennedy., 456 U.S. 667,675 (1982).

The Courts of Appeals have recognized that the trial courts, not the appellate courts, are the proper forum for determining that intent. *United States v. Dante*, 739 F.2d 547 (11th Cir.1984); *United States v. Wodtke*, 711 F.2d 86 (8th Cir.1983).

Had the *Piambino II* panel followed what it believed the *Piambino I* panel intended to do—instruct the district court to determine the intent of counsel and whether a conflict existed—its decision would have been consistent with the decisions of this Court which leave fact finding to the district Courts.

Instead, the panel usurped the district court's role and in so doing, posed conflict with the due process clause.

II

THE DECISION BELOW, BY ENGAGING IN APPELLATE FACT FINDING WHICH PRETERMITTED THE OPPORTUNITY FOR AN EVIDENTIARY INQUIRY CONFLICTS WITH THE DUE PROCESS DECISIONS OF THIS COURT REQUIRING A MEANINGFUL OPPORTUNITY TO BE HEARD PRIOR TO THE TAKING OF PROTECTED PROPERTY AND LIBERTY INTERESTS.

The Petitioners, and the three thousand clients Carl H. Hoffman represented, had received funds pursuant to presumptively valid orders of the district court. Based upon *Piambino II*'s appellate *de novo* finding that there was a conflict of interest "since the case began" (the Florida case began in 1973), those property rights have been destroyed. Moreover, they were destroyed by a decision which, by terminating the lawyer-client relationship, precluded the class action plaintiffs from seeking rehearing in the Court of Appeals, or certiorari review here.

The district court never tried the issue of whether Lead Counsel achieved a settlement "primarily to provide . . . an attorneys' fee"; or whether Lead Counsel "knew . . . Sylva's appeal was meritorious"; or "knew that the . . . injunction was baseless"; or "could not have been surprised" with the *Piambino I* decision; or "knew that . . . their settlement would fall." 757 F.2d 1140, 1141; A 126-128.

Thus, without any opportunity for the kind of process which always precedes findings of fact, the Court of Appeals terminated constitutionally protected property and liberty interests.

Several protected interests are implicated here. First, the money. Second, the interest in utilizing the appellate remedies of rehearing and certiorari guaranteed by the Federal Rules of Appellate Procedure and United States Statutes. Third, the petitioners' name, integrity and reputation.

Board of Regents v. Roth, 408 U.S. 564 (1972), leaves no doubt that property interests "extend well beyond . . . money", and liberty interests include "good name, reputation, honor or integrity." *Id.*, at 572,573. Additionally, property interests are also "defined by existing rules . . . ." *Id.*, at 577.

Roth, and the body of due process law including *Fuentes v. Shevin*, 407 U.S. 67 (1972); *Bell v. Burson*, 402 U.S. 535 (1971); *Wisconsin v. Constantineau*, 400 U.S. 433 (1971); *Goldberg v. Kelly*, 397 U.S. 254 (1970); *Sniadach v. Family Finance Corporation*, 395 U.S. 337 (1969) guarantee the right to be heard prior to the taking of one's property. The right to presentation of evidence is a critical component of due process. *Goldberg v. Kelly*, 397 U.S. at 268.

The decision below, by usurping the traditional role of a trial court to provide those guarantees before affecting property interests, conflicts with established due process principles.

It is one thing, after an issue has been tried, to terminate a lawyer-client relationship and find selfish motive and conflict. But it is quite another thing to reach that result *sans* an evidentiary hearing, and, in the process, deprive the lawyers' clients of their otherwise guaranteed rights to subsequent judicial review.

If an appellate court may, consistent with due process of law, dispense with the usual evidentiary fact finding procedure in determining conflict between counsel and class action clients with the resultant effect of depriving counsel and clients of protected property and liberty interests, then that important question should be answered by this Court.

III

THE DECISION BELOW PRESENTS IMPORTANT BUT UNANSWERED QUESTIONS REGARDING THE USE OF MANDAMUS AND THE SUPERVISORY POWERS DOCTRINE AND CONFLICTS WITH THE DECISIONS OF THIS COURT AUTHORIZING THE USE OF THOSE EXTRAORDINARY REMEDIES AND POWERS.

A. *Mandamus*

Sylva did not seek mandamus relief. The *Piambino II* panel *sua sponte* turned the appeal into a 28 U.S.C. §1651 mandamus. 757 F.2d 1115; A66. Sylva viewed the case as one involving an "abuse of discretion", Sylva Brief at 2. Indeed sixteen months passed between issuance of the mandate in *Piambino I* and Sylva's attempt to enforce that mandate in the district court. *See*, Docket Entries, Nos. 1468 and 1506.

Throughout *Piambino II* the panel referred to its "implicit" holdings in *Piambino I*. 757 F.2d at 1120,1122; A 79-83. *Piambino II* was explicit in its acknowledgment that *Piambino I* did not instruct the district court to determine whether there was a conflict between Lead Counsel and clients. 757 F.2d 1139; A 123. In fact, the

Piambino I panel sent a different message to the district court by rejecting an invitation to independently evaluate the fees:

> This is not our normal practice; however, since the District Court is infinitely better situated to conduct the factual inquiry necessary under *Johnson* [*v. Georgia Highway Express*, 488 F.2d 714 (5th Cir. 1974).

Mandamus is an extraordinary remedy.

> [I]t is clear that only exceptional circumstances amounting to a judicial "usurpation of power" will justify the invocation of this extraordinary remedy . . . Thus the writ has been invoked where unwarranted judicial action threatened to embarrass the executive arm of the government in conducting foreign relations", . . . where it was the only means of forestalling intrusion by the federal judiciary on a delicate area of federal-state relations . . . where it was necessary to confine a lower court to the *terms* of an appellate tribunal's mandate. . . .
>
> *Will v. United States* 389 U.S. 90,95 (1967) (emphasis supplied) (citations omitted).

Piambino I contained no terms which warranted the subsequent use of mandamus in Piambino II. Sylva's characterization of the appeal as one involving an "abuse of discretion" belies the propriety of mandamus. Sylva's sixteen month wait between issuance of the *Piambino I* mandate and his motion to enforce it (Docket Entries 1468 and 1506) underscores the impropriety of mandamus. The *Piambino II* panel's acknowledgment that had the

Piambino I panel known the resistance to be mounted to returning the distributed funds it "would have instructed the district court to determine [if there was a conflict]" undermines the *Piambino II* use of mandamus.

Thus there was either conflict with this Court's restrictive view of mandamus, or, if its use was proper, the Court should answer that important question.[3]

B. *Supervisory Powers*

The court below invoked its "supervisory power" to "bring an end to Lead Counsel's role as class attorneys in this case." 757 F.2d 1145; A 139. It sought to justify its use with references to *McNabb v. United States*, 318 U.S. 332,340-41 (1943), *Klapprott v. United States*, 335 U.S. 601 (1949) and *Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704,710-11 (7th Cir.1979).

Neither *McNabb*, *Klapprott*, *Photovest* nor the numerous other appellate cases which have called upon the supervisory power doctrine used it to summarily terminate a lawyer-client relationship. Indeed, the panel's citations implicitly acknowledge the dearth of specific authority for its rationale, focusing instead on its objective of "fashioning procedures and remedies that ensure that the judicial process remains a fair one." 757 F.2d 1146; A 139.

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[3]In *Vendo Company v. Lektro-Vend Corporation*, 434 U.S. 424 (1978) the Court said that mandamus was available if a lower court "disobeys and mistakes" the meaning of an appellate mandate. But to mistake the meaning of a mandate means the mandate conveyed an unambiguous meaning. One cannot disobey an unclear instruction, or an instruction which is subsequently determined to be what the mandate would have been had the appellate court been apprised of facts it did no know when it ruled.

That goal is the touchstone of the supervisory powers doctrine, *see* Note, *The Supervisory Power of the Federal Courts*, 76 Harv.L.Rev. 1656,1659 (1963). But laudable goals may only be reached *via* constitutional means.

> [Due process] expresses the requirement of "fundamental fairness," a requirement whose meaning can be as opaque as its importance is lofty. Applying the Due Process clause is therefore an uncertain enterprise which must discover what "fundamental fairness" consists of in a particular situation by first considering any relevant precedents and then by assessing the several interests that are at stake.
>
> *Lassiter v. Department of Social Services of Durham County*, 452 U.S. 18,24 (1981).

Here no precedents justified the use of the supervisory powers doctrine to summarily terminate a longstanding lawyer-client relationship and deprive the lawyer and clients of property and liberty interests.

If such supervisory power action is to be tolerated, then this Court should address its fairness.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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Appendix

Peter PIAMBINO et al.,
Plaintiffs-Appellees,

v.

William E. BAILEY et al., Defendants,

Bestline Products, Inc., a California
Corporation et al.,
Defendants-Appellants.

In re BESTLINE PRODUCTS SECURITIES
AND ANTITRUST LITIGATION.

Peter PIAMBINO et al.,
Plaintiffs-Appellees,

v.

William E. BAILEY et al., Defendants,

David SYLVA, Compliance Officer of the
California Restitutionary Fund,
Intervenor-Appellant.

Nos. 76-3495, 77-2045.

United States Court of Appeals,
Fifth Circuit.

Feb. 6, 1980.

* * *

Before COLEMAN, Chief Judge, GOLDBERG, and RUBIN, Circuit Judges.

COLEMAN, Chief Judge.

This litigation arose from the sale by Bestline Products, Inc.,[1] a California corporation, of direct

[1]Bestline Products, Inc., is a California corporation wholly owned by Bestline Corporation, another California corporation. In this opinion these corporations will be collectively referred to as "Bestline".

distributorship contracts (or agreements) for the sale and distribution to the consuming public of its line of personal and home care products. Bestline's direct distributorships were an integral part of its multi-level distributorship system, a species of pyramid sales schemes.[2]

The complexities of this case remind us of the ancient Gordian Knot. Involved here are eleven lawsuits transferred to the Southern District of Florida for coordinated or consolidated pretrial proceedings with a suit previously filed in that district.[3] The two appeals taken to this Court from those proceedings, and now before us, have also been consolidated.[4]

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[2]For a detailed analysis of such schemes, see Note, *Pyramid Schemes: Dare to be Regulated*, 61 Geo.L.J. 1257 (1973).

[3]In 1974 the Judicial Panel on Multidistrict Litigation transferred six cases to the Southern District of Florida for consolidation with the case of *Piambino v. Bailey*, No. 73-1230—Civ. *In re Bestline Products Securities and Antitrust Litigation*, 375 F.Supp. 926 (Jud.Pan.Mult.Lit. 1974). Later, it transferred four Texas cases to the Florida court, 405 F.Supp. 313 (Jud.Pan.Mult.Lit. 1975), as well as one North Carolina case. Most of these cases were class actions and alleged violations of the federal securities laws and various state laws.

[4]In No. 76-3495, on August 6, 1976, the defendants filed notice of appeal from three different orders of the District Court: (1) the Order Determining Motions for Summary Judgment, dated March 19, 1976; (2) the Preliminary Injunction, dated July 7, 1976; and (3) the Order Allowing Reimbursement of Costs and Disbursements of James H. Joseph, dated July 15, 1976. The appellants filed their opening brief in December 1976, and the State of California filed an amicus brief in January 1977. The parties then began settlement negotiations and moved this Court for a stay of the appeal proceedings, which motion was granted.

Included is a class of nearly 40,000 plaintiffs. There are several corporate defendants, a law firm defendant, and over 60 individual defendants. Swept up in the proceedings are scores of lawyers, the attorneys general of seven states, the Federal Trade Commission, and the Department of Justice. Various state and federal courts have decided related cases.

In this appeal, the parties have raised many issues, including: (1) the management of class actions and complex litigation; (2) the interpretation of 28 U.S.C. § 2283 (the "Anti-Injunction Act"); and (3) the definition of a "security" for purposes of the federal securities laws.

We hold that summary judgment declaring the distributorships to be securities was improvidently entered. After a consideration of all issues we reverse and remand for further proceedings not inconsistent herewith.

(Footnote 4 Continued)

Although the settlement which was finally approved by the District Court included a requirement that the defendants dismiss their appeal in No. 76-3495, they refused to do so when David Sylva appealed from the denial of his motion to intervene and from the order approving the settlement. The latter appeal was docketed as No. 77-2045, and the two appeals were consolidated for oral argument. In January 1979 the plaintiffs filed their opening brief in No. 76-3495.

I.

BESTLINE'S ORGANIZATION AND HISTORY[5]

Bestline Products, Inc. began its activities in August, 1966, when defendants William E. Bailey and Jerry G. Brassfield organized a multilevel direct sales organization to sell and distribute a line of biodegradable soap products. Bailey and Brassfield had previously been associated as distributors for Holiday Magic, Inc., a multilevel direct sales company which sold cosmetic products. Those men had additional experience with pyramid sales schemes resulting from their work with several other (ultimately unsuccessful) companies.

From its inception, Bestline was a successful venture, at least until the rising flood of lawsuits and regulatory actions began to overwhelm it. Bestline recruited other individuals with experience in multi-level direct sales and grew until it became an operation in all fifty states and several foreign countries. By March, 1972, its initial meager line of cleaning agents and home care products had expanded to sixteen in number. Six of the products were manufactured by Bestline in its own facilities in San Jose, California and Elk Grove Village, Illinois; various other companies manufactured the remaining items.

In order to share the ownership of the company with other loyal and devoted participants in its direct sales program, in 1968 Bailey and Brassfield organized the Bestline Corporation and sold their interest in Bestline

[5]Most of the discussion under this heading is taken from the District Court's Opinion and Order Determining Motions from Summary Judgment. *See In re Bestline Products Securities*, 412 F.Supp. 732 (S.D. Fla. 1976).

Products, Inc. to the new corporation for $10 million. They sold some stock in the new corporation to others, but they retained the majority ownership for themselves. Bailey was the chief executive officer and chairman of the board until August 1973, when Brassfield returned to the organization he had left in 1970. As the business expanded, the officers and top executives of Bestline received ever-expanding compensation packages, including six-figure salaries and such perquisites as use of the corporate aircraft and yacht.

The most important factor in Bestline's success, and an equally important factor in its legal problems, was its "National Marketing Plan", a plan that was implemented through three levels of independent distributors. At the lowest level were the "Local Distributors",[6] who paid $5 annual dues and sold Bestline's products directly to the consuming public. At the second, or middle, level were the "Direct Distributors". The status of "Direct Distributor" could be achieved by a Local Distributor who sold approximately $5,000 worth of products in a month. The status could also be obtained by a prepurchase plan. A person could become a Direct Distributor by paying $3,400 in cash; for this sum, the purchaser received classification as a Direct Distributor and soap products having a retail price of $5,000 together with sales aids. Such a purchaser was required to serve as a Local Distributor for seven days and, while a Local

[6]Although Local Distributors could recruit other Local Distributors to sell for them, the profits achieved by a Local Distributor turned solely upon sales to the consuming public. Bestline paid no commissions or bonuses to persons at the lowest level. Consequently, no party to these suits has alleged that this aspect of the scheme violated the federal securities laws. As certified by the District Court, the class did not include any Local Distributors.

Distributor, to buy $100 (later $500) worth of Bestline products. Unlike Local Distributors, Direct Distributors were not required to sell products to the consuming public or even to Local Distributors whom they sponsored. They could engage in recruiting Local Distributors to sell the products, but they could also recruit other persons to become prepurchase Direct Distributors. If a Direct Distributor successfully recruited two new Direct Distributors, he became qualified to move up to the third, and highest, level, that of "General Distributor". This level in the Bestline hierarchy could be attained only by persons who first qualified as Direct Distributors and then satisfied certain other requirements.

The district court certified as the class plaintiffs only repurchase Direct Distributors. Thus, the action does not involve Local Distributors, Local Distributors who earned the status of Direct Distributor by selling soap products or General Distributors.

Profits at the various levels were in part dependent on the volume of sales to lower levels and to the consuming public. A Local Distributor purchased the products from his sponsoring Direct Distributor at a discount that varied from 30% to 52% off of the retail price, depending upon his monthly sales. A Direct Distributor purchased the products for resale to his Local Distributors and to the public at a 52% discount. At the top of the pyramid, a General Distributor purchased the products for resale to his Director Distributors, his Local Distributors, and the public at a 60% discount.

A person at any of the three levels could profit by selling Bestline's products to the public (which all levels were authorized to do) or by recruiting other distributors (which all levels were also authorized to do). In fact

substantial sales of Bestline products were made, about $1,000,000 per month at one point. (The record is not clear, however, what part of these sales were made to consumers and what part remained in the hands of various classes of distributors.)

As is the case with most such pyramid sales schemes, however, the lure of big profits came not from the opportunity to sell Bestline's products to the consuming public but from the opportunity to recruit others who would in turn recruit or sell. The district court discussed four different methods by which Bestline Direct and General Distributors could profit from the recruitment of new distributors: (1) the release fee; (2) the standard commission; (3) the override commission; and (4) the special incentive bonus (SIB).

The release fee practice, which Bestline abandoned in 1970, was the simplest method by which a person in the top level profited from the recruitment aspect of the National Marketing Plan. Under this program, a Direct Distributor who wished to move up was required to pay Bestline a $2750 fee, of which Bestline paid $2250 to the Direct Distributor's sponsoring General Distributor (generally, the one who had initially recruited the Direct Distributor). Ostensibly, this fee was paid to release oneself from his General Distributor's organization and compensate the latter for the loss of commission which would be experienced when the Direct Distributor left that organization. This fee therefore provided General Distributors with an incentive to encourage their Direct Distributors to move up the pyramid. Equally as obvious,

however, is the fact that the release fee provided no incentive for Direct Distributors.[7]

The second method by which individuals profited from the recruitment of others was the standard commission. This resulted from the 8% differential in discounts between General and Direct Distributors, and it was applied to all "product movement" between those two levels. This standard commission therefore provided an incentive for General Distributors to recruit more Direct Distributors, to whom they could sell Bestline products at 48% of retail after having purchased such products from the company at 40% of retail. The General Distributors could therefore achieve a rapid 20% return on their outlays.

The override commission was a 3% commission paid to the sponsor of a sponsoring distributor. The sponsor of a sponsoring distributor was entitled to this commission solely because he had initially recruited the initial distributor, even though he may have played no part in the subsequent recruitment. This commission therefore provided an incentive for distributors to recruit people who in turn would be good recruiters and not merely good retailers of Bestline's products.

The fourth method, the special incentive bonus, was introduced by Bestline shortly after it eliminated the release fee practice. SIB's were paid on an annual basis to qualifying General, but not Direct, Distributors and were a progressive percentage of product movement.

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[7]Unless, of course, it was the expectation that one would eventually move up to the position of General Distributor and then be in a position to recruit other Direct Distributors, who might eventually pay the release fee in order to move themselves up in the hierarchy.

Product movement consisted not only of products that were sold to ultimate consumers, but also of products that remained in the hands of a distributor who either was unable to unload them on another distributor or was unwilling or unable to sell them to the public. A General Distributor had to account for at least $36,000 in product movement to be eligible for any SIB. His commission would be 3.3% at that level, but if he could push $200,000 in products, his commission rate jumped to 15%, or earnings of $30,000.

One device utilized by Bestline to advance and implement corporate policy was the monthly meeting of its "Corporate Team", which included key home office officials, assistant vice-presidents, and Regional Directors. These meetings were used to announce changes in policy and to motivate Bestline's personnel. A key feature of these meetings was the constant exhortation to hold "Opportunity Meetings" and to adhere closely to the script provided by the company for use at these meetings.

The district court found that dozens, if not hundreds of opportunity meetings were conducted almost daily throughout the United States.[8] These meetings involved the gathering of a group of Bestline distributors and prospective recruits in a hotel or motel meeting room, or any other suitable place. The prospects were

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[8]Bestline's Opportunity Meetings differed little from the meetings which have been integral parts of other pyramid sales schemes. *Compare SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 476 (5th Cir. 1974); *SEC v. Glenn W. Turner Enterprises, Inc.*, 348 F.Supp. 766, 770-71 (D.Cre. 1972), *aff'd*, 474 F.2d 476 (9th Cir. 1973), *cert. denied*, 414 U.S. 821, 94 S.Ct. 117, 38 L.Ed.2d 53 (1973); *see generally* Note, Pryamid Schemes: Dare to be Regulated, 61 Geo.L.J. 1257, 1259 (1973).

systematically exhorted to take advantage of the Bestline "opportunity". To insure uniformity at each of the thousands of Opportunity Meetings, Bestline distributed scripts for speakers to use at such meetings, as well as records, film strips, and copies of the "Bestline Business Opportunity Booklet." Bestline corporate officials frequently conducted the meetings at least to insure adherence to company policy.

The Opportunity Meetings were the means by which Bestline distributors were urged to build an "organization" of distributors whom they sponsored. The time and place of each Opportunity Meeting was reported to the Bestline home office and assembled into a regularly published "Corporate Calendar" which listed all the meetings currently planned across the country. By means of this calendar, Bestline distributors could, as they were urged to do by Bestline, refer friends or acquaintances in distant locations to a convenience Opportunity Meeting in their city or locale. If the distant prospect signed up for a distributorship, the referring friend became his sponsor and therefore received a share of the commissions paid on the products purchased from Bestline by the distant prospect, even if the referring friend took no part in the actual recruitment of the distant prospect other than inviting him to the Opportunity Meeting.

The Bestline system for computing the amount of regular commissions, override commissions and SIB bonuses which it paid to its distributors was based on Bestline's concept of "product movement," which gave credit for both retail and "wholesale" sales. Because of the Credit for wholesale business, one effect of the "product movement" was to reward distributors for the recruitment of new prepurchase Direct Distributors.

And since prepurchase Direct Distributors were required to make large initial purchases to qualify for their position, a General Distributor who sponsored a prepurchase Direct Distributor would receive a substantial commission, and possibly an SIB bonus, on the new distributor's initial purchase, even if the new distributor made no attempt to sell the products which he had purchased to the consuming public. Nor did the new prepurchase Direct Distributor need to sell any of his inventory in order to make a profit. He could instead concentrate his efforts on the "wholesale" part of the business, and try to recruit new prepurchase Direct Distributors whose initial purchases could be applied toward fulfilling his own requirements for becoming a General Distributor. The incentive for becoming a General Distributor is revealed by the fact that, while a General Distributor generally earned a lesser net discount on product sales (as little as 8%) than did a Direct Distributor (as high as 20%), only a General Distributor was entitled to receive commissions and credit toward his SIB bonus for the initial purchases made by newly recruited prepurchase Direct Distributors whom he sponsored.

Thus, although the class certified as plaintiffs includes only prepurchase Direct Distributors, the route to highest profits was by becoming a General Distributor. Becoming a Direct Distributor and then recruiting another Direct Distributor was the only way to achieve the top of the pyramid, General Distributor status.[9]

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[9]According to the district court's opinion, prior to 1970 a Direct Distributor could qualify as a General Distributor by (1) recruiting a new prepurchase Direct Distributor to replace him in his sponsoring General Distributor's organization; and (2) paying a $2,750 release fee to Bestline, $2,250 of which was then paid by Bestline to the ascending distributor's former sponsoring General Distributor, and $500 of which was retained by Bestline. Beginning

II.

BESTLINE'S LEGAL BATTLES

Prosperity to the contrary notwithstanding, Bestline soon found itself defending lawsuits brought by the federal government, by the attorneys general of seven states, and by numerous private plaintiffs.

In 1971 Bestline entered into a consent decree with the Federal Trade Commission wherein it agreed to cease and desist from alleged unfair trade practices in connection with the recruitment of new distributors.[10]

On May 21, 1971, the State of California filed a civil suit against Bestline and certain of its officials *alleging violations of state law.*[11] On July 25, 1973, after a lengthy trial, the Los Angeles County Superior Court

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(Footnote 9 Continued)

in 1970, however, a Direct Distributor could become a General Distributor only by (1) recruiting a Direct Distributor to replace himself in his sponsoring General Distributor's organization; (2) paying a $600 (later $700) fee to Bestline for attendance at "General Distributor's School"; and (3) generating, either through retail or "wholesale" sales volume (the latter category including the initial "pre-purchase" sales to newly recruited pre-purchase Direct Distributors), $5000 of "product movement" in a single month.

[10]The pertinent provisions of that consent decree can be found in *United States v. Bestline Products Corp.*, 412 F.Supp. 754, 760-61 n. 2 (N.D.Cal. 1976).

[11]Specifically, California alleged violations of California Business and Professions Code §17500 (deceptive advertising) and Civil Code §3369 (unfair competition). Earlier, on January 14, 1971, Bestline had signed a consent decree with the State and had agreed to cease and desist from employing certain marketing and advertising practices.

entered a written judgment in the case, ordering injunctive relief, restitution to certain California Bestline distributors, and a total of $1,902,500 ($1,000,000 against Bestline) in civil penalties. In addition, the order provided for the appointment of a receiver to effectuate the restitutionary provisions. After the state court judge had announced his decision from the bench, but two days before the written opinion issued, Bestline filed a Chapter XI bankruptcy petition in the Northern District of California. That court issued a stay order which prevented the California Attorney General from enforcing the state court judgment.

While the Chapter XI proceedings inched forward, extensive negotiations took place. New management took over control of Bestline and the California Attorney General's office negotiated with the new management. These discussions bore fruit on December 21, 1973, when the parties and the Superior Court signed a modified judgment that expanded the restitution program so that certain non-California Bestline distributors could participate in it. Pursuant to this modified judgment, Bestline transferred $4,085,936.61 into an irrevocable restitutionary trust to be administered by the Bank of America. Bestline agreed to make periodic payments, beginning January 1, 1976, to the fund until full restitution had been achieved, and it withdrew its bankruptcy petition. The modified judgment also empowered the Attorney General to seek termination of the trust agreement if Bestline failed to make regular payments. In addition, the court postponed Bestline's payment of $1,000,000 in civil penalties until full restitution had been achieved.

Three categories of distributors were eligible to participate in the California restitution program. These were:

(1) Each individual who became a Direct Distributor or a Candidate Direct Distributor in California after January 14, 1971, to and including July 25, 1973, and who requests a refund;

(2) Any individual who is entitled to restitution pursuant to agreement reached between any other state or political subdivision thereof or any federal department or agency and Bestline Products, Inc., and/or Bestline Corporation.

(3) Any other individual who became a Candidate Direct Distributor or Direct Distributor in Bestline in any state other than those specified [above] who has satisfied any of the following conditions: (1) the company approves the claim; (2) the distributor has received an arbitration award pursuant to a national plan of arbitration, or (3) pursuant to judgment.

The avowed purpose of this program as modified was to keep the company afloat so that restitution could be maximized. If large judgments were obtained against Bestline, and if subsequent plaintiffs sought to enforce those judgments, the company would become bankrupt. Therefore, any plaintiff obtaining a judgment could elect to join the California restitution program, or he could attempt to enforce his judgment, depending upon his own perception of which course of action he thought would enhance his recovery.

Bestline appealed the Superior Court judgment but did not challenge its restitutionary features. The lower court was affirmed on all issues appealed, *People v. Bestline Products, Inc.*, 61 Cal.App.3d 879, 132 Cal.Rptr. 767 (1976).

The record does not indicate how many individual cases, if any, proceeded to judgment, but public bodies brought a number of suits which either proceeded to judgment or were settled. The New York City Bureau of Consumer Protection and the Attorneys General of Missouri, Ohio, Pennsylvania, New Jersey, Texas, and Wisconsin successfully brought suits against Bestline on behalf of former Bestline distributors in their respective jurisdictions. All of these seven classes elected to join the California restitution program rather than execute their judgments.

In the meantime, private lawsuits against Bestline and various officers of the company were filed in several federal courts across the country, and the scramble for the assets of Bestline began in earnest. For example, on July 20, 1973, counsel for the Piambino plaintiffs filed their class action lawsuit in the Southern District of Florida.

Lead counsel[12] for the consolidated actions made several attempts in California courts to disrupt the California restitution payments. The initial effort began on September 20, 1974, when one of the two lead counsel sent a letter to the Bank of America, the fund trustee, claiming that the class had a prior equity in the trust and warning the bank that it "will be held liable to them [the class] for their proportional interest in any funds disbursed after your receipt of this letter." Another letter, dated October 8, 1974, threatened "to commence

[12]The District Judge appointed as lead counsel for the consolidated proceedings the two attorneys, Carl H. Hoffman and James H. Joseph, who had filed the class action lawsuit on behalf of the Piambino plaintiffs in the Southern District of Florida. These two attorneys have acted as lead counsel throughout the litigation.

legal proceedings against the Bank of America to enjoin any distribution of funds from the Bestline trust . . . [and which would seek] recovery of the proportional interest in any funds disbursed by the Bank to which the putative class is entitled." Since the Bank was scheduled to disburse payments to the participants in the restitution program in the near future, it was concerned about these threats and petitioned the California Superior Court for instructions. After a hearing attended by all interested parties, including lead counsel for the Florida class, the state court ordered the bank to make the disbursements. Bestline did not appeal that decision, even though it may have been entitled to do so under state law. *See County of Alameda v. Carleson*, 5 Cal.3d 730, 97 Cal.Rptr. 385, 488 P.2d 953 (1971).

The very next day, lead counsel filed a class action suit in the Northern District of California alleging that the distribution of money through the restitution fund constituted "common law fraud and deceit" and deprived their clients of due process and equal protection. Plaintiffs sought an injunction "restraining Bank of America, [the compliance officer], Bestline, Bestline Corporation, [the California Attorney General] and the Superior Court from issuing any further instructions to [the compliance officer] and/or Bank of America inconsistent with the claims of [the plaintiff class], and restraining Bank of America from any distribution of said funds inconsistent with the rights of [the plaintiff class] to share ratably therein." Counsel then petitioned the Judicial Panel on Multi-district Litigation to treat the action as a tag-along case with the Florida cases. A conditional transfer order was summarily issued, but the defendants promptly moved to vacate that order. After a hearing, the defendants' motion was granted

on February 14, 1975, whereupon the parties returned to the Northern District of California, where the court notified all the parties that a hearing would be held on March 28, 1975. Plaintiffs' counsel failed to appear at that hearing, and the court granted the defendants' motion to dismiss under Rule 12(b) *with prejudice*. Judgment was entered, the plaintiffs appealed, and the Ninth Circuit *dismissed* the appeal without opinion.

At this point, if not before, the California state court judgments became absolutely final and entitled to full faith and credit.

On April 2, 1976, pursuant to a complaint filed by the Federal Trade Commission, the United States District Court for the Northern District of California found that Bestline had violated the injunction issued as a part of the 1971 consent decree. Among other things, the Federal Trade Commission obtained a judgment of $1,036,000 against the defendant, William Bailey, dated July 19, 1976, *United States v. Bestline Products Corporation*, 412 F.Supp. 754 (N.D.Cal. 1976). This money was paid into the registry of that Court.

In the meantime, as will hereinafter be related, the District Court in Florida had brought the enforcement of the California state court judgment to a halt by enjoining Bestline from complying with the California state court judgment. The District Court in California transferred the $1,036,000 from its registry to that of the Southern District of Florida for distribution to members of the plaintiff class in that Court.

After the total lack of success in both the State and Federal Courts in California, ending with the dismissal of the appeal in the Ninth Circuit, plaintiffs' counsel resorted again to the Southern District of Florida, where discovery proceeded apace.

On March 19, 1976, the District Judge rendered an opinion and order granting the plaintiffs' motion for summary judgment on the limited issue of whether the prepurchase Direct Distributorship agreements were "securities" for purposes of the Securities Act of 1933 and the Securities Exchange Act of 1934. Meanwhile, on January 1, 1976, Bestline had made its first scheduled payment of $250,000 to the restitution fund, and it had notified the compliance officer that it would be able to make its second periodic payment, in the amount of $500,000, as scheduled on June 30, 1976. This apparently alarmed lead counsel and on June 18, 1976 less than two weeks prior to the scheduled date of payment, they moved the Florida District Court for a temporary restraining order to prohibit Bestline from transferring the money to the Bank of America. Lead counsel recognized the problem presented by 28 U.S.C. §2283, the Anti-Injunction Act, and submitted a brief to the District Court arguing that the court could issue the injunction on the ground that the plaintiff class had been deprived of some right secured to it by the 1871 Civil Rights Act, 42 U.S.C. §1981 *et seq.*, and on the ground that such an injunction was permitted under the "where necessary in aid of its jurisdiction" exception contained in the statute. The court held a hearing on June 30, 1976, the very day that Bestline was scheduled to make the payment, and after the Bank of America had gone to considerable expense in preparing checks and envelopes for the mailing of individual checks to the approximately 7,043 persons then participating in the restitution program.[13] A representative of the

[13]Of this total, approximately 2300 resided at one time or another in California. Except for four people whom Bestline had authorized to participate in the fund, all of the other participating members joined the fund pursuant to judgments or settlements

California Attorney General appeared at the hearing and argued, as did the defendants, that 28 U.S.C. §2283 barred the injunction. From the bench, the District Judge enjoined Bestline from making the payment, and, when the defendants demanded that the plaintiffs post a security deposit for damages in accordance with the requirements of Rule 65(c) of the Federal Rules of Civil Procedure, the Judge decided that the $500,000 would be deposited into the registry of the court and would serve as the security deposit. Unfortunately, we think, the written order completely avoided the question of whether the Anti-Injunction Act barred the injunction. The District Court simply opined that "it would be inequitable to allow the California Plan participants to continue to receive payments from Bestline where the other members of the Plaintiff class were effectively precluded from participating in the California Plan because of matters outside of their control." Thus, after being clearly apprised of the barrier posed by the Anti-Injunction Act, both in written briefs and in oral argument at the June 30 hearing, the District Judge failed to address the problem and issued the injunction.[13] The defendants filed a timely notice of appeal.

(Footnote 13 Continued)

secured by six different state attorneys general or, in the case of New York City, by a Consumer Protection Bureau.

[14]After the District Court enjoined Bestline, it missed six payments to the restitution fund:

Date	Amount
June 30, 1976	the greater of $500,000 or 50% of pre-tax profits
Jan. 1, 1977	$500,000
June 30, 1977	the greater of $750,000 or 50% of pre-tax profits
Jan. 1, 1978	$750,000
June 30, 1978	the greater of $1,000,000 or 50% of pre-tax profits
Jan. 1, 1979	$1,000,000

Bestline's new Chief Executive, Bailey, then began serious settlement negotiations with lead counsel. On October 20, 1976, the District Court entered an order preliminarily approving a settlement between Bailey and the class. The settlement provided that the funds obtained by the FTC and then on deposit in the registry of the court in the Northern District of California would be paid into the registry of the Southern District of Florida in return for a complete release of all claims against Bailey. It further provided that Bailey would not have to pay any money above what he had already paid in the FTC case, and that the funds could be used for the payment of attorneys' fees to Lead Counsel. The District Court, at Bestline's expense, sent notice to all members of the class concerning the proposed settlement and then held hearings, at which the Department of Justice appeared to protest the award of $250,000 in attorneys' fees to Lead Counsel out of funds generated by a successful FTC prosecution. Despite these objections, the Florida District Court concluded that Lead Counsel had made a substantial contribution to making those funds available for the plaintiff class,[15] and awarded the attorneys' fees in an order dated February 25, 1977.

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[15]In the Northern District of California, Judge Renfrew's extensive opinion does not mention any contribution by Lead Counsel to the FTC case. *See United States v. Bestline Products Corp.*, 412 F.Supp. 754. *In the Southern District of Florida no written findings of fact were issued in support of the conclusion that lead counsel had made a substantial contribution in the FTC case.*

III.

THE ALLEGED SECURITY

In the appeals now before us, the district court held (1) that there was no genuine issue as to any material fact bearing on the question of whether the prepurchase Direct Distributorships sold to the plaintiffs by Bestline were investment contracts within the meaning of federal securities laws and (2) that *those distributorships were securities.*

In *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473 (5 Cir., 1974), this Court held that for purposes of the Securities Act of 1983[16] and the Securities Exchange Act of 1934[17] a pyramid distribution system is a security.

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[16]Section 2(1) of the Securities Act of 1933, 15 U.S.C. §77b(1), provides as follows:

> (1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

[17]The definition of a "security" in §3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. §78c(a)(10), is substantially identical to that contained in the Securities Act, and the coverage of the Acts may be regarded as the same. *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 99 S.Ct. 790, 795 n. 7, 58 L.Ed.2d 808.

The question of whether the direct distributorships were "investment contracts" concerned the District Court. *See In re Bestline Products Securities*, 412 F.Supp. 732 (S.D.Fla. 1976). In

PIAMBINO v. BAILEY Cite as 610 F.2d 1306 (1980) It was recognized that the test for an "investment contract" had been spelled out by the Supreme Court in *SEC v. W. J. Howey Company*, 328 U.S. 293, 298-299, 66 S.Ct. 1100, 1103, 90 L.Ed. 1244, (1946):

> "[A]n investment contract for purposes of the Securities Act, means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits *solely from the efforts of the promoter or a third party.* (Emphasis supplied).

After analyzing subsequent Supreme Court cases involving the investment contract issue along with lower court interpretations of *Howey*, and scholarly commentary, the *Koscot* Court concluded that a literal application of the *Howey* test, "solely from the efforts of the promoter or a third party", would frustrate the remedial purposes of the Acts. Therefore, the Ninth Circuit standard was adopted: "[W]hether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise", 497 F.2d at 483 [quoting *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 (9 Cir., 1973), *cert. denied*, 414 U.S. 821, 94 S.Ct. 117, 38 L.Ed. 53 (1937)]. As applied to the facts in *Koscot*, it was held that efforts of the promoters in setting up and conducting the Adventure Meetings, which were designed to entice people to join the scheme,

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(Footnote 17 Continued)

this Court, there is no contention that the phrases "certificate of interest or participation in any profit-sharing agreement" or "any interest or instrument commonly known as a 'security' " are broader in scope, for purposes of this case, than the term "investment contract".

were the "essential managerial efforts" without which the enterprise would fail.

Since the *Koscot* decision the Supreme Court has decided two cases involving the definition of investment contracts, *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 99 S.Ct. 790, 58 L.Ed.2d 808 (1979), and *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 95 S.Ct. 2051, 44 L.Ed.2d 621 (1975).[18]

In both decisions, rejecting the arguments of the Securities and Exchange Commission, the Supreme

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[18]See, also *SEC v. Sloan*, 436 U.S. 103, 98 S.Ct. 1702, 56 L.Ed.2d 148 (1978); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 97 S.Ct. 1292, 51 L.Ed.2d 480 (1977); *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 97 S.Ct. 926, 51 L.Ed.2d 124 (1977); *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976); *Ernst and Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976); *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232, 96 S.Ct. 508, 46 L.Ed.2d 464 (1976); *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 95 S.Ct. 2069, 45 L.Ed.2d 12 (1975); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975); *Securities Investor Protection Corp. v. Barbour*, 421 U.S. 412, 95 S.Ct. 1733, 44 L.Ed.2d 263 (1975); *see generally* Lowenfels, *Recent Supreme Court Decisions Under the Federal Securities Laws: The Pendulum Swings*, 65 Geo.L.J. 891 (1977).

The District Court in this case had the benefit of the *Forman* decision before granting summary judgment on the security issue, but it seems not to have grasped the significance of that case. According to the District Court, the language quoted in the text meant that the Supreme Court had restated the *Howey* test. "By focusing on the *quality* of the efforts of others, the Supreme Court read the word 'solely' out of the *Howey* test, it having become so much surplusage, thereby according to its prior *Howey* decision the flexibility originally intended." 412 F.Supp. at 737-38. The District Court failed to deal with the remainder of the *Forman* decision, however.

Court reversed lower court holdings that the transactions at issue were investment contracts, and hence securities. The significant thing is that the Court expressly reaffirmed the test first enunciated in *Howey*, which had been on the books for thirty years.

In *Forman* the Court stated, "[t]he touchstone is the presence of an investment in a common venture premised *on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others*"[19] (emphasis added), 421 U.S. at 852, 95 S.Ct. at 2060.

It should be noted that the test is to be applied in light of the "substance—the economic realities of the transaction—rather than the names that may have been employed by the parties", *Daniel, supra*, 439 U.S. at 558, 99 S.Ct. at 796.

In *Forman*, the Court emphasized, that, "in searching for the meaning and scope of the word 'security' in the

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[19]The essential vice of chain or pyramid distribution schemes has been well documented. For example, if the founder recruited five distributors in the first month and if those five each recruited five more distributors in month two, and if each of these subsequent recruits enticed five people to join in the month following his own recruitment, over 244 million new distributors would be recruited in the twelfth month. Obviously, this would be impossible in a nation of only 220 million people. Equally as obvious is the fact that those who have the greatest risk of loss are those who enter the pyramid when the market is closest to saturation. This seems largely an element of chance, and it is just such a realization that has prompted courts all over the country to declare such schemes to be prohibited lotteries. *See generally* Annot., 54 A.L.R.3d 217, 227-31. The disclosure which would be necessary to inform a new investor of his prospects for success or failure would have to change almost daily in order to reflect the acquisition of new distributors. Needless to say, there would be substantial administrative obstacles connected with any such regime of disclosure.

Act[s], form should be disregarded for substance and the emphasis should be on economic reality", 421 U.S. at 848, 95 S.Ct. at 2058.

As in *Koscot* and *Turner*, as well as in *SEC v. Galaxy Foods, Inc.*, 556 F.2d 559 (2 Cir., 1977), and *Bell v. Health-Mor*, 549 F.2d 342 (5 Cir., 1977), there were two distinct aspects to the distribution system set up by Bestline. These were the *retail sales* portion of the business on one hand and the recruiting portion on the other, but it would appear, without our so deciding, that these aspects were both integral parts of one common scheme. The degree of investor participation and control differed significantly with respect to each of these aspects.

Following the approach applied in *Securities and Exchange Commission v. United Benefit Life Insurance Company*, 387 U.S. 202, 207, 87 S.Ct. 1557, 18 L.Ed.2d 673 (1967), the district court here, like the courts in *Turner*, *Koscot*, *Galaxy*, and *Health-Mor*, separated these distinct aspects of the Bestline operation for purposes of its analysis. It also discussed the *Howey* formation of "profits" as meaning either "capital appreciation resulting from the development of the initial investment" or "a participation in earnings resulting from the use of investors' funds", 421 U.S. at 852, 95 S.Ct. at 2060.[20]

It is apparent that the purchasers of Bestline Direct Distributorships would not profit by "capital appreciation resulting from the development of the initial investment".

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[20]In a footnote, the Court also noted the Ninth Circuit decision in *SEC v. Glenn W. Turner Enterprises, Inc., supra.* The Court stated that the "solely from the efforts of others" part of the *Howey* test was not presented in *Forman* and that it expressed no opinion on the Ninth Circuit's holding. 421 U.S. at 852 n. 16, 95 S.Ct. at 2060 n. 16.

Neither is there any indication that prepurchasers of Direct Distributors expected a "participation in earnings resulting from the use of investors' funds".

This relegates us to the standards long ago articulated, and more recently reaffirmed, by the Supreme Court.

An examination of the Bestline Business Opportunity Booklet, coupled with the Applications, Qualification Forms, and Agreements required to be executed by Direct Distributors, clearly established that the efforts of Bestline and its "Corporate Team" certainly constituted the "common thread" on which all of the distributor's "beads" were strung, *see Securities and Exchange Commission v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 348, 64 S.Ct. 120, 88 L.Ed. 88 (1943).

The person directing the Opportunity Meeting asks his audience of prospective joiners, "How do you do it? You get plenty of help. * * * *We all work together on this*" (App. 32a-33a, emphasis supplied).

Actually, it was not the Direct Distributorship, as such, but the General Distributorship that purportedly would yield the anticipated great returns. It was at the latter level that Bestline emphasized the building and supervisory aspects of the business, with which Bestline promised "plenty of help". The assurances of "plenty of help" infers that the person receiving that help would also have to be exerting efforts of his own, else there would be no need for help. "We all work together on this" could be construed as notice that it would be necessary for the "investors" to "work".

Becoming first a Direct Distributor was prerequisite to becoming a General Distributor but the "over-all

facts" and Bestline's presentation might be construed as holding out a promise that a prepurchase Direct Distributor would never have to retail the product at all; he would simply have to locate other prospects and bring them to the meetings, thus jumping immediately to General Distributorship level without exerting substantial effort.

There were parts of the Bestline presentation which would support a finding by a judge or a jury that no reasonable "investor" could have believed that he was relying *solely on Bestline.* At the General Distributors meetings the presentation constantly emphasized the retail aspects of the business. "The retail part may seem very elementary to you but I want you to understand how important it is, particularly to a General Distributor. . . . Although you're at 60%, 60% of nothing is nothing, so it's vitally important that sales occur, and of course, it is your job to assure that they do". The presentation then discussed the non-retail aspects of the business—building an organization and supervising it. The General Distributor's responsibility was to "train and motivate these people to do a good job". How? Plenty of help. It is implicit in this reference that retail sales will take place. The night meeting emphasized retail sales and the saleability of the product.

The meeting leader then discussed the prepurchase plan. This discussion focused on recruitment since that was integral to advancing from Direct Distributor to General Distributor. Moreover, the promise of greatest profits was linked to becoming a General Distributor. The meeting also discussed the risk involved and there was evidence that might lead the trier of fact to conclude that Bestline intended to dispel (and dispelled) the belief that it was promising profits with no expenditure

of effort. The presentation listed three ways to generate product movement volume: (1) retail sales through one's own accounts. "It generally takes experience in commercial selling to be successful in that area. But if you have that experience or acquire it, that can be one way . . ." (2) Simpler for those without sales experience is to sell that amount through local distributors. (3) "Strictly a hypothetical illustration", would be by recruiting people as Direct Distributors and training them as General Distributors. "You must train your people and continue to work closely with them". Finally, the printed material accompanying the Bestline presentation did not mention personal efforts by the Direct Distributor.

In a summary judgment context what it all comes down to is:

1. Different inferences could be drawn from the facts in the record as to whether the Bestline Direct Distributorship Plan could be separated into two parts;

2. If the fact finder (judge or jury) were to hold that the Direct Distributorship Plan could be separated into two parts, one of which would be the recruitment of Direct Distributors, different inferences could be drawn from the facts in the record as to whether anticipated profits were to come solely by Bestline's efforts, with no substantial personal effort on the part of the "investor".

This, of course, would be determined on the expectations of a "reasonable investor" as prompted by Bestline's standardized presentation, rather than the subjective beliefs of any particular individuals, *see Internal Brotherhood of Teamster, supra*, 99 S.Ct. at 797; *United States Housing Foundation, Inc. v. Forman*, 421 U.S. at 852, 95 S.Ct. 2051. The motivation of particular

individuals might vary; the application of the statute must be objectively based.

What a "reasonable investor" would under all the circumstances expect is for determination by the trier of fact in much the same manner as the determination of what a reasonable person would or would not have done concerning acts claimed to have been negligent. Such issues can properly be resolved by summary judgment only if (1) there is no genuine dispute concerning any material fact and (2) no conflicting inferences could be drawn from those established facts.

[1] After considering all the facts most favorably to the party against whom summary judgment is sought summary judgment may be entered, of course, if no jury could reasonably reach any conclusion except that reasonable investors did (or did not) believe they were buying into an enterprise whose profits would be determined by Bestline managerial and entrepreneurial methods with no substantial effort by the investor. Up to now, however, this is not such a case.

On what we have before us, the entry of summary judgment must be reversed and the case remanded for further proceedings conducted consistently with the applicable jurisprudence.

It should not be necessary for us to say that we intimate no opinion whatever as to how this case should be resolved on remand.

IV.

SYLVA'S APPLICATION TO INTERVENE

[2] It is well settled that one who has sought intervention of right may appeal from an order denying

his application and that an appellate court will reverse if it concludes that he was entitled to intervene of right. *Cascade Natural Gas Corp. v. El Paso Natural Gas Co.*, 386 U.S. 129, 87 S.Ct. 932, 17 L.Ed.2d 814 (1967); *Stallworth v. Monsanto Co.*, 558 F.2d 257, 263 (5th Cir. 1977). In its order entering final judgment as to certain of the defendants, dated March 22, 1977, the District Court denied Sylva's petition to intervene as "both untimely and without merit". Thus, the Court concluded that Sylva did not satisfy Rule 24(a)'s requirements that an application for intervention of right be timely and that, on the merits, "[1] the applicant claims an interest relating to the property or transaction which is the subject of the action and [2] he is so situated that the disposition of the action may as a practical matter impair or impede his ability to protect that interest, unless [3] the applicant's interest is adequately represented by existing parties." Fed.R.Civ.P. 24(a).

[3] In the recent case of *Stallworth v. Monsanto Co.*, *supra*, we exhaustively surveyed the jurisprudence on Rule 24's "timeliness" requirement and recognized that this question is largely committed to the discretion of the district court. Consequently, its determination will not be overturned on appeal unless an abuse of discretion is shown. *Id.* at 263. Although such discretionary determinations must necessarily consider all the facts and circumstances of the particular case, *NAACP v. New York*, 413 U.S. 345, 366, 93 S.Ct. 2591, 2603, 37 L.Ed.2d 648 (1973), the *Stallworth* panel identified four factors which must, as a minimum, be considered in passing upon the timeliness of a petition to intervene. These factors were listed as: (1) the length of time during which the would-be intervenor actually knew or reasonably should have known of his interest in the

case before he petitioned for leave to intervene; (2) the extent of the prejudice that the existing parties to the litigation may suffer as a result of the would-be intervenor's failure to apply for intervention as soon as he actually knew or reasonably should have known of his interest in the case; (3) the extent of the prejudice that the would-be intervenor may suffer if his petition for leave to intervene is denied; and (4) the existence of unusual circumstances militating either for or against a determination that the application is timely. *Id.* at 264-66.

Proper consideration of these factors generally cannot be divorced from a consideration of the merits of a prospective intervenor's application, however. For instance, factor 1 clearly requires an initial identification of the prospective intervenor's interest in the case, and factor 3 requires a similar identification of that interest in order to assess the potential of prejudice to him. Furthermore, the question of timeliness is at least partially linked to the question of adequate representative. *See United Airlines, Inc. v. McDonald*, 432 U.S. 386, 394, 97 S.Ct. 2464, 2470, 53 L.Ed.2d 423 (1977) ("as soon as it became clear to the [intervenor] that the interests of the unnamed class members would no longer be protected by the named class representatives, she promptly moved to intervene to protect those interests."); *Allegheny Corp. v. Kirby*, 344 F.2d 571, 574 (2d Cir. 1965) (timeliness also turns on "when the interests of the proposed intervenors were no longer properly represented") (construing pre-1966 rule). Due to these problems, we should analyze the merits of Sylva's application to intervene before considering whether it was timely.

First, what interest does Sylva have "relating to the property or transaction which is the subject of the action"? Our cases have required that intervention of right be supported by a "direct, substantial, legally protectable interest in the proceedings." *See United States v. Perry County Bd. of Education*, 567 F.2d 277, 279 (5th Cir. 1978); *Diaz v. Southern Drilling Corp.*, 427 F.2d 1118, 1124 (5th Cir. 1970), *cert. denied sub nom. Trefina A. G. v. United States*, 400 U.S. 878, 91 S.Ct. 118, 27 L.Ed. 115 (1970). Furthermore, Sylva "has standing to prosecute a suit in the federal courts only if he is the 'real party in interest' as that term is defined under Fed.R.Civ.P. 17(a). The stricture applies to intervenors as well as plaintiffs." *United States v. 936.71 Acres of Land, More or Less, in Brevard County, State of Florida*, 418 F.2d 551, 556 (5th Cir. 1969).

Sylva admits that he has never been a Bestline distributor at any level, nor has he ever been an employee or stockholder of the corporation. Although he sought to intervene on behalf of the 7,043 participants in the California restitution fund and to be appointed as a representative of a subclass consisting of those persons, we need not consider whether such an interest would satisfy Rule 24(a) because Sylva clearly has another interest in this litigation which he may assert, namely, his own duties as Compliance Officer in administering the restitution fund and as receiver of the Bestline properties in California.

[4] It is the general rule that courts must look to the substantive law creating the right being sued upon to determine compliance with the real party in interest requirement, and for at least two reasons we look to California law in order to measure Sylva's claims. First, Sylva seeks to intervene in his capacity as the Compliance

Officer of a restitution fund which was set up by a state court judgment to remedy violations of state law. In order to participate in that fund, every direct distributor with a judgment was required to waive "any and all rights and remedies available to him against corporate defendants with the exception of those rights and remedies available under the plan of restitution". This is obviously an interest created by the substantive law of California. Second, although this case involves primarily claims assertedly arising under federal law, it also involves pendent state law claims which the settlement purports to extinguish. At least to protect the interests of the California fund participants in those claims, we should look to California law.

[5, 6] We are satisfied that, as Compliance Officer, Sylva is the trustee of an express trust who may sue in the California state courts under Cal.Civ.Proc. Code Section 369 (West 1973), and in the federal courts under Fed.R.Civ.P. 17(a). Under California law, "[t]he nature, extent, and object of a trust are expressed in the declaration of trust", Cal.Civ.Code Section 2253 (West 1973), and the primary rule in the construction of trusts is that the court must, if possible, ascertain and effectuate the intention of the trustor. *Ephraim v. Metropolitan Trust Company of California*, 28 Cal.2d 824, 834, 172 P.2d 501 (1946). In this case, the Superior Court is the trustor, *see* Cal.Civ.Code Section 2252 (West 1973), and we must therefore discern the intention of that court in creating the trust. "[W]hen a declaration of trust is made in writing, all previous declarations by the same trustor are merged therein," *id.* at §2254, but when documents are executed contemporaneously with the trust agreement and are cross-referenced to each other, as were the Modified Judgment, Instructions to

Compliance Officer, and Trust Agreement in this case, they must be regarded as one instrument. *See Security-First Nat. Bank of Los Angeles v. Ogilvie*, 47 Cal.App.2d 787, 792, 119 P.2d 25 (1941). Finally, the terms of a trust agreement may empower someone other than the named trustee to sue and be sued on behalf of the beneficiaries of the trust. *Cf. Powers v. Ashton*, 45 Cal.App.3d 783, 119 Cal.Rptr. 729 (1975).

The California restitution fund was formally established by three separate documents—the Modified Judgment, the Instructions to Compliance Officer, and the Trust Agreement, all of which were signed in December 1973. The Trust Agreement is somewhat brief and contains only 12 short paragraphs. It named the Bank of America as trustee of the "irrevocable, express trust", and spelled out the trustee's duties. These were: (1) to maximize the interest earned by the corpus of the trust; (2) to distribute payments to the participants in the fund as directed by the Compliance Officer; (3) to account to Bestline, the California Attorney General and the Compliance Officer for all payments made from the fund; and (4) to pay the fees and expenses of the Compliance Officer after Bestline and the California Attorney General had approved them. The agreement also expressly mentioned the Instructions to Compliance Officer (a copy of which was attached to the Trust Agreement) and stated that the Bank of America "shall have no discretion or authority or responsibility under the provisions of [the Instructions]." Finally, the agreement stated that it was to be governed by the laws of California, and it did not affirmatively state that the Bank of America was to have the duty to enforce the rights of the beneficiaries whom it represented.

In contrast to the Trust Agreement, the Instructions to Compliance Officer is a detailed document and defines the Compliance Officer's duties quite explicitly and definitively. He was to send proof of claim forms to each former distributor who became eligible to participate in the fund and to calculate the amount of refund due each person returning such form. He was to make the restitutionary payments on a pro rata basis according to a schedule established in the Instructions. Most importantly, the Instructions provided that "Said Compliance Officer shall have full and complete authority and power to supervise, control, carry out, oversee and enforce the restitutionary provisions set forth herein. Said Compliance Officer shall perform all necessary and proper acts to effectuate said purpose." To insure his ability to carry out these responsibilities, the Instructions granted him "all necessary power and authority to employ persons and legal counsel to assist him" and provided for the payment of his reasonable fees and expenses from the trust fund.

[7] Thus, it seems apparent that the express trust created by the California Superior Court contemplated a division of authority and responsibility. The Bank of America was to control and invest the funds and to make the payments as directed by the Compliance Officer. These duties are among those normally assumed by a trustee and are mainly ministerial. The Compliance Officer, although not formally designated as the "trustee" assumed significantly more important responsibilities and was, in fact, the real fiduciary in the arrangement. The Court gave him broad oversight responsibilities, charged him with enforcing the restitutionary provisions, and gave him the means (financial resources and manpower) to carry out his responsibilities. We have not the faintest doubt that the California Superior

Court contemplated that the Compliance Officer, and not the Bank of America, would assume that vital and essential duty—the enforcement of the terms of the express trust on behalf of the beneficiaries of the trust—through legal action if necessary. We therefore conclude that the Compliance Officer is a "trustee of an express trust" within the meaning of that term in Rule 17(a), and is a real party in interest for purposes of this litigation.

Any doubts which might have been entertained about the correctness of that conclusion have surely been dispelled by subsequent events. The Compliance officer has kept himself abreast of the litigation in Florida from its inception and has been involved in several proceedings in the California Superior Court. In fact, Lead Counsel for the plaintiffs in this case even though that the Compliance Officer was such a critical actor that they named him as a defendant in their class action suit filed in the Northern District of California and sought to have him enjoined from issuing any further instructions to the Bank of America inconsistent with the claims of the plaintiff class. *See* p. 1314, *supra.* When that fact is considered, it is, to say the least, disingenuous for the plaintiffs now to deny that Sylva has any interest in the instant proceedings and to claim that the District Court properly denied his intervention.

The preceding discussion leads inexorably to the conclusion that Sylva, in his position of Compliance Officer, was in fact a trustee and, as such, had a "direct, substantial, legally protectable interest" in these

proceedings.[21] He has at all times acted in the best interests of the beneficiaries of the restitution fund, and the Florida litigation directly affected his ability to fulfill those responsibilities. Indeed, as will be demonstrated shortly, the Florida litigation threatened to snuff out his ability to comply with the directives of the California Superior Court.

We also think it quite clear that Sylva, as Compliance Officer, was so situated that the disposition of the action would as a practical matter impair or impede his ability to protect his interest as the representative of the restitution fund. Not only did the District Court intend to liquidate Bestline's assets, but he intended to distribute the proceeds *only* to class members "who have not previously been admitted to participation in the California restitutionary fund." Furthermore, all members of the California fund would be bound by the Florida judgment, except for those who had opted out early in the proceedings.

The manner in which the California fund members were treated in this litigation is illustrated well by the series of notices which they received. On November 22,

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[21]Because we have concluded that Sylva's position as Compliance Officer was an interest sufficient to warrant intervention of right, we have no occasion to address the separate question of whether his appointment as receiver of Bestline's California properties by the Superior Court on February 14, 1977, was sufficient to warrant intervention of right. The record on appeal is insufficiently developed on this point and reveals only that the California Court had appointed him and issued instructions to take possession of the assets, liquidate them, and transfer the proceeds to the restitution fund for ultimate distribution to its participants. The briefs of the parties have informed us that Sylva has carried out those duties, and, if that is indeed the case, his interest in these proceedings by virtue of his appointment as receiver might well be moot. We, of course, express no opinion on any of these points.

1974, the District Court certified a class of plaintiffs consisting of

> all persons who purchased or invested in Direct Distributorship contracts or agreements, or their equivalents, offered by Bestline Products, Inc., who never qualified as General Distributors of Bestline Products, Inc., or their equivalents, and who have not re-ordered products from Bestline Products, Inc., within the six (6) months next preceding the date of this order. . . .[22]

On January 15, 1975, the court notified potential class members, including participants in the California fund, that a class had been designated and that unless they requested exclusion, their interests would be represented by lead counsel. At that time, the California fund had just made its second payment, and many of the participants undoubtedly were confused by this notice of yet another lawsuit. A substantial percentage took no action and thereby became members of the class. When the District Court's injunction prevented the mailing of the mid-1976 payments, many of the California fund participants became anxious about the delay and contacted the Compliance Officer, who informed them that an appeal had been taken and that there was no cause for alarm. In December 1976, the District Court preliminarily approved the settlement with William Bailey and sent notice to all members of the class,

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[22]As finally modified on October 21, 1976, the class included all persons who purchased or invested in Direct Distributorship contracts or agreements, or their equivalents, offered by Bestline Products, Inc., who never qualified as General Distributors of Bestline Products, Inc., or their equivalents, and who are not active distributors as evidenced by current renewal of their mailing list privileges.

along with a proof of claim form. This notice, however, clearly stated that *no* payments would be distributed to persons who had previously participated in the California fund. It also stated that the Court expected to take no further action with respect to the money obtained from Bestline until its appeal had been decided; as events later unfolded, this promise proved to be an empty one. Understandably, many of the California group did not return proof of claim forms to the court. In December 1977 the court preliminarily approved the Bestline settlement and then sent notice of the proposed settlement *only* to those persons who had returned the proof of claim forms. Thus, it appears that the California fund participants were lulled into mistakenly thinking that their rights were being protected and that they were members of the plaintiff class. Suddenly, the court informed them that they would not participate in the funds distributed pursuant to the settlement. When they did not return proof of claim forms because they knew that they would get no money, the court declined to send them notice of the final, more important settlement (to be discussed, post).

Thus, the members of the California group were not given the treatment contemplated by the law, and they would be bound by a final judgment which completely shut them off from any hope of monetary recovery. It necessarily follows that Sylva's ability to protect his interest as a trustee would not only be impeded or impaired, but it would be utterly destroyed.

Much of the foregoing discussion makes it clear that Sylva was not represented at all in this litigation when the parties agreed to a settlement, one provision of which was that Bestline would abandon its appeal to

this Court. Sylva was then, and only then, left "without a friend in this litigation." *See Atlantis Development Corp. v. United States*, 379 F.2d 818, 825 (5th Cir. 1967).

[8] To sum up, we conclude that, on the merits, Sylva was entitled *of right* to intervene.

The only remaining inquiry is whether his application was timely.

Each of the *Stallworth* factors on timeliness points toward the conclusion that the application was timely. First, although the Compliance Officer knew as early as June 30, 1976, when the injunction issued, that he had an interest in the litigation that might be impaired, there was absolutely no reason for him to intervene at that time. Bestline immediately appealed and filed a sterling brief with this Court. In addition, Bestline's attorneys met on several occasions with the Compliance Officer, the California Attorney General, and the Superior Court Judge and assured these people that they were prosecuting the appeal diligently and in good faith.[23] In

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[23]Sylva outlined the position of the Superior Court as follows in his deposition:

> Q. Concerning your discussions with Bestline about the appeal, you indicated that you had monthly hearings before Judge Hupp and there was discussions at that time. Can you give me a little bit more detail about the discussions, what was indicated about Bestline pursuing the appeal?
>
> A. [Compliance Officer] Only that—okay, to give you some background, upon the five thousand [sic] being paid over to the Florida Court, California Attorney General's Office took that as being a breach of the agreement between Bestline and the Attorney General's Office, and immediately sought to enforce its judgment, have a receiver appointed.
>
> At the same time, as we understand it, there were motions in Florida for the appointment of receivers. Judge Hupp did

reliance upon those representations, and upon the obviously adequate representation of Bestline's attorneys, the Superior Court Judge refused the Attorney General's request for a receivership and Sylva did not attempt to intervene. On January 28, 1977, when the settlement agreement was filed, Sylva then knew that his interests

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(Footnote 23 Continued)

not want this thing to deteriorate into a race to the courthouse to determine which group of people obtained the judgment, and got the most money. He rather would have liked to have seen some sort of a cooperative effort in resolving the whole matter, making sure all of the people, including the Florida people, received at least partial restitution of the funds that they had been bilked out of.

In light of this appeal [of] Judge Hupp, he was advised that the court ordered—the judgment of the Florida Court was being appealed, and that the appeal was progressing nicely and that the briefs were being filed or had been filed, you know, each month and there would be a progress report by Mr. Pitto and Mr. Humphreys [attorneys for Bestline]. Those were thoughts in mind— but in the meantime the California Attorney General's Office is champing at the bit to close down Bestline. They are taking a very aggressive posture on behalf of, I guess, the citizens of California and all the other attorney generals who agreed with their posture.

It was in light of these discussions that the trial court, the California Superior Court, would not rule on the motions of the Attorney General to shut everything down. It just—preservation of the status quo, let's not get excited here, things are going to work out, was in light of these remarks of the judge and reports by Bestline's attorneys that the thing continued to rock along from July up until February.

* * * * * *

Q. So that the Attorney General put off the proceeding on his receivership motion, and the court put off ruling on those motions, and you put off taking any action in Florida on the basis that Bestline was appealing this specific seizure of the half a million dollars?

A. Yes. that's correct . . . (A. 758-760).

were no longer adequately represented by Bestline, and his motion to intervene was filed on February 14. This delay of a mere seventeen days cannot rationally be denominated as unreasonable.

Furthermore, the existing parties have suffered no prejudice from the delay. This is not a case where intervention was attempted after the entry of a final judgment, *see United Airlines, Inc. v. McDonald*, 432 U.S. 385, 97 S.Ct. 2464, 53 L.Ed.2d 423 (1977); *McDonald v. E. J. Lavino Co.*, 430 F.2d 1065, 1072 (5th Cir. 1970); nor is it a case where more hearings must be held in the lower court. In this case, Sylva presented three witnesses at the hearing on the settlement and fully developed his position. The parties are in exactly the same position they would be if some members of the class had objected to the settlement and then taken an appeal to this Court. As has already been demonstrated, there was a distinct probability that the confusing, if not deceptive, series of notices guaranteed that no members of the California group would appear at the hearing to protest the settlement.[24] In short, the parties have not been prejudiced legally by the brief delay in filing the application to intervene.

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[24]Sylva's three witnesses testified that they had difficulty understanding the notice and that they did not need to file the proof of claim form since they had previously filed in California.

"Q. (Ms. Greer) Did you take any steps to file a Proof of Claim Form?

A. (Norman Feinberg) No.

Q. Why didn't you file a Proof of Claim form after trying to read that, the Notice?

A. Well, I thought I didn't have to.

Q. Why did you think you didn't have to?

A. Because I already had. There was a contract entered between New York City and Bestline. And then I subsequently asked three lawyers, which [sic] said 'I

It is unnecessary for us to recount the substantial prejudice which will be visited upon Sylva and the members of the California group if his motion to intervene

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(Footnote 24 Continued)

don't know how an agreement entered by a court could be nullified, so that agreement would have to stand.' Now, I thought I would suffer if I would subscribe to this." (A. 808).

* * * * * *

"Q. (Ms. Greer) So the fact that you had already filed a claim in California, you had been notified you didn't have to participate, that convinced you not to file in Miami?

A. (Valentin Dominguez) I thought I didn't have to.

Q. Did you speak to any other Bestline distributors concerning the Notice?

A. Yes, I did; a couple distributors. And in fact one of them was from California, and he was in the same—I don't even know the name of the fellow. He happened to ask me that I was a distributor because he saw some of the products that I was using; and he was from California. And as I understand it, he didn't participate in the Class neither.

Q. Do you have any personal knowledge of why he didn't participate?

A. We discussed the situation. And he says, 'Well, we don't have to. We covered from California.'" (A. 816-817).

* * * * * *

"Q. (By Ms. Greer) Mr. Dominguez, is it correct that the reason you did not file here in Florida is because you had already filed a claim in California?

A. Right. And they have all the records that I have, plus the fact that the form that I got from Florida requires me to file an inventory and an amount of money that I invested in Bestline. I didn't have anything like that because it was sent to California.

Q. Then you sent all of your documents and supporting information to California when you filed your claim there?

is denied. In addition to the facts already recounted, it should be noted that the District Court also intended to appoint a receiver with instructions to liquidate all

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(Footnote 24 Continued)

A. To California, right." (A. 818).

"Q. (By Ms. Greer) Please tell the Court what you did when you received the Notice.

A. (By Susie Rosenrot) When I received the letter, you know, I answer saying I don't see any I have to make another claim because I already did it." (A. 822).

* * * * * *

"Q. (By Ms. Greer) Mrs. Rosenrot, what steps did you take to try to get information about the Notice? What did you do to try to get information?

A. I wrote the letter to Mr. Dan Sylva saying that I did not see why I have to do it all over again because I already filed it so I could not understand it.

Q. Did you read the Notice?

A. I read it but I could not understand too much, you know. I don't know why I had to do that." (A. 823).

* * * * * *

"Q. (By Ms. Greer) Did you file a Proof of Claim form here in Florida?

A. No.

Q. Other than writing that letter?

A. That's right.

Q. You wrote that letter for more information?

A. That's all.

Q. Do you have the documents for your claim or did you send them to California?

A. I sent everything to California when I made the claim.

Q. So that the California Fund has all of your documents and the claim form?

A. That's right." (A. 825-826).

* * * * * *

of Bestline's assets. Such an action might have affected Sylva's ability to carry out the Superior Court's instructions to him to liquidate Bestline's California assets. We also think that the manner in which this group was treated in the Florida litigation, including the fact that the District Court failed to employ the subclassing power spelled out in Rule 23(c)(4)(B) and to designate a representative for the California group, is an "unusual circumstance" militating for a determination that the application is timely. *See Stallworth, supra* at 266.

Therefore, we hold that it was error as a matter of law to deny Sylva's application to intervene and we reverse on this point.

V.

THE BAILEY AND BESTLINE SETTLEMENTS

By separate orders, the District Court approved two settlements. In the first order, dated February 15, 1977 (the Bailey Settlement), the Court entered final judgment as to defendant William Bailey and dismissed all claims against Bailey with prejudice. *Bailey gave no consideration whatsoever for the release of these claims;* the Court's order merely directs him to apply to the Northern District of California pursuant to the final judgment in the FTC case for an order directing the clerk of that court to transfer the amount of $1,036,000 to the Southern District of Florida. No notice of appeal was filed from the February 15 order, nor could there have been due to the lack of a Rule 54(b) certificate. On February 25 the District Court directed the payment of $250,000 in attorneys' fees to lead counsel from the Bailey settlement funds.

In the second order, dated March 22, 1977 (the Bestline Settlement), the District Court approved a settlement to which Bestline and 27 individual defendants had subscribed. In return for the dismissal of all claims against them with prejudice, the defendants agreed: (1) to pay $900,000 (collectively); (2) to tender a note for $300,000 (executed by Bestline Products. Inc. and guaranteed by Brassfield); (3) to pay whatever sums might be realized by liquidating Bestline's assets (approximately $600,000); and (4) to waive any claim to the $491,636.59 deposited with the court pursuant to the preliminary injunction, plus interest. This settlement also provided that attorneys' fees of $750,000 and expenses of up to $50,000 would be paid out of this fund. The March 22 order both denied intervention and entered final judgment as to the settling defendants.

Our jurisdiction to review the merits of the settlement can be supported on three grounds. First, this may be a case for invoking the "hardship finality" doctrine of *Forgay v. Conrad*, 47 U.S. (6 How.) 201, 12 L.Ed. 404 (1848), since the District Court immediately ordered the payment of attorneys' fees out of the settlement proceeds. This was surely an execution on the judgment. *See generally* 15 C. Wright, A. Miller & E. Cooper, Federal Practice & Procedure §3910 (1976). In the circumstances of this case, there seems to be no reason not to review the merits of the settlement since the intervenor has already presented his evidence and arguments to the lower court. Second, the order entered final judgment as to Bestline, which had been enjoined by the court since June 30, 1976. The order was therefore appealable under 28 U.S.C. §1292(a)(1) as an interlocutory order dissolving an injunction. Finally, the order appointed lead counsel as "trustees" of the real and personal

property of Bestline with instructions to liquidate the property within six months in a commercially reasonable manner. We have no doubt that this was in effect an appointment of a receiver and was an order appealable under 28 U.S.C. §1292(a)(2). "A receiver by any other name, or by no name, is still a receiver." *United States v. Sylacauga Properties, Inc.*, 323 F.2d 487, 490 (5th Cir. 1963).

We shall examine only Sylva's objections to the Bestline settlement.

[9] Rule 23(2) requires the trial judge to review any proposed settlement of a class action. The purpose of this salutary requirement is to protect the nonparty members of the class from unjust or unfair settlements affecting their rights. 7A C. Wright & A. Miller, Federal Practice & Procedure §1797, at 226 (1972). Conflicts may arise between the attorney and the class, between the named plaintiffs and the absentees, and between various subclasses.

[10, 11] To minimize the first conflict—that between the attorney and the class—district courts must address the issue of attorneys' fees under the standards of *Johnson v. Georgia Highway Express*, 488 F.2d 714 (5th Cir., 1974). If the agreement leaves attorneys' fees to be fixed by the Court then, as stated in *In re Air Crash Disaster at Florida Everglades*, 549 F.2d 1006, 1021 (5th Cir. 1971):

> The district court must set and conduct a hearing in the full sense of the word and must address the fee issue under the *Johnson* standards. [C]ounsel must offer relevant evidence and must be available for cross-examination. The court should enter findings of fact and conclusions of law setting out the basis

for the fee award and adequately presenting the issue for further appellate review should this be necessary.

[12, 13] *See also Norwood v. Harrison*, 581 F.2d 518 (5th Cir., 1978); *Premier Corp. v. Serrano*, 578 F.2d 566 (5th Cir.), *cert. denied sub nom. Premier Corp. v. Shevin, Shapo & Shevin, P.A.*, 439 U.S. 1003, 99 S.Ct. 613, 58 L.Ed.2d 678 (1978). If he has not done so, then he must require that notice be given to the class of the proposed attorneys' fees as well as the rest of the settlement agreement and afford anyone who objects an opportunity to be heard. Finally, he must himself determine whether the attorneys' fees proposed are reasonable. A district court is not bound by the agreement of the parties as to the amount of attorneys' fees. *Foster v. Boise-Cascade, Inc.*, 577 F.2d 335 (5th Cir. 1978), affirming 420 F.Supp. 674 (S.D., Tex., 1976). In fixing the amount of attorneys' fees the court must, of course, take all of the *Johnson* criteria into account, including the difficulty of the case and the uncertainty of recovery. He is not, however, merely to ratify a pre-arranged compact.

The second and third conflicts are much more difficult to prevent and police. Generally, courts depend upon structuring the settlement process to promote adequate representation and, hopefully, fair settlements. As a backstop, the law requires that the trial court evaluate whether the settlement is fair, adequate and reasonable and is not the product of fraud or collusion. *Pettway v. American Cast Iron Pipe Company*, 576 F.2d 1157, 1169 (5th Cir. 1978); *Cotton v. Hinton*, 559 F.2d 1326, 1330 (5th Cir. 1977); *Miller v. Republic National Life Insurance Company*, 559 F.2d 426, 428, 429 (5th Cir. 1977); *Young v. Katz*, 447 F.2d 431, 433 (5th Cir.

1971). Against these concerns must be weighed the general policy of the law to favor settlements and to uphold them whenever possible because they produce an amicable resolution of disputes and minimize demands on judicial time and resources. *Pettway, supra*, at 1214; *Miller, supra*, at 428.

We are convinced that the District Court fell into serious error when it approved the attorneys' fees proposed in the Bestline settlement. The order entering final judgment states:

> This court is not being asked to set reasonable attorney's fees in conjunction with the instant settlement; rather the court is being presented with a proposed settlement, agreed to by all parties and unopposed by the class, which incorporates an award of attorney's fees in the amount of $750,000 as a vital part of the settlement. Certainly, different procedures and considerations might obtain were the court being requested to initially fix an attorney's fee. Since the award and amount of attorney's fees comes before the court in the posture of an unopposed settlement, the court finds that the amount is reasonable under the circumstances of this protracted and complicated case. (Emphasis in original.)

[14] On this reasoning, the District Court abdicated its responsibility to assess the reasonableness of attorneys' fees proposed under a settlement of a class action, and its approval of the settlement must be reversed on this ground alone.

On this appeal, the parties to the settlement urge that the record is adequately developed to enable this Court to independently evaluate the reasonableness of those fees. This is not our normal practice, however,

since the District Court is infinitely better situated to conduct the factual inquiry necessary under *Johnson*, and since we are not asked to determine reasonable attorneys' fees incident to an appeal to this Court. See *Davis v. Roadway Express, Inc.*, 590 F.2d 140 (5th Cir. 1979).

[15] Regrettably, this does not end the matter. For reasons about to be stated, we must vacate in its entirety the order entering final judgment as to Bestline and 27 individual defendants.

This is demanded by the failure to assess the interests of the two categories of plaintiffs and whether the settlement was fair, adequate and reasonable *as to each.*[25] One group of plaintiffs was comprised of the 7,043 participants in the California restitution fund, all of whom had either reduced their claims against the defendants to a judgment or had settled. Approximately $4.5 million had been distributed to these persons before the District Judge issued his preliminary injunction halting further payments from Bestline to the Bank of America. Although that recovery may seem large when compared to the proposed settlement in this case, it must be remembered that those 7,043 people had an average claim against Bestline of $3000 each, for a

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[25]If this were simply a case of defining the zone of acceptable settlements, we would look to the standards set forth by the Supreme Court in a bankruptcy approval case, *Protective Committee v. Anderson*, 390 U.S. 414, 424-25, 88 S.Ct. 1157, 20 L.Ed.2d 1 (1968). Those criteria would be especially applicable in this case because the assets of the corporation were so likely to be liquidated. *See also Cotton v. Hinton*, 5 Cir. 1977, 559 F.2d 1326; *Miller v. Republic National Life Ins. Co.*, 5 Cir. 1977, 559 F.2d 426, 429; *Developments in the Law—Class Actions*, 89 Harv.L.Rev. 1318, 1573-75 (1976).

total claim of perhaps $21 million. Rather than execute their judgments and force Bestline into bankruptcy, those 7,043 people chose to accept smaller installment payments and to keep Bestline afloat for the greater good of all concerned. Cf. *Marshall v. Holiday Magic, Inc.*, 550 F.2d 1173, 1178 (9th Cir. 1977) (approving a similar settlement in a pyramid scheme nearly identical to that involved in this case). Since the issuance of the preliminary injunction, Bestline has failed to make at least $4,500,000 in payments to the California restitution fund. *See* note 14, *supra*. Therefore the members of the fund have been deprived of over $600, on the average, to which they were entitled as a result of their judgments against Bestline. The interest of these 7,043 people in protecting their judgments has not been adequately recognized or protected. This is not a bankruptcy proceeding in which the debtor's assets are being parcelled out to creditors on an equitable basis.[26] The participants in the California fund all had judgments that were entitled to full faith and credit under Article IV of the Constitution and 28 U.S.C. §1738. As the amicus brief filed by the State of Wisconsin indicates, those 7,043 people waived their rights to pursue any claims against Bestline, either as part of their judgments or upon

[26]The February 10, 1977, Notice of Proposed Partial Settlement of Litigation contains some interesting statistics concerning the composition of the class which was certified. Notice was originally mailed to approximately 34,000 potential plaintiffs. 3,744 of these elected to exclude themselves from the litigation, and 8,779 of the notices were returned as undeliverable. Of the remaining class members, 4,332 completed and returned a proof of claim form. Apparently, the District Judge intended to distribute the settlement proceeds only to those 4,332 people. The record on appeal does not indicate how many of the California group excluded themselves from the litigation or how many filed proof of claim forms in Florida.

joining the California fund. Unless those waivers were somehow not entitled to full faith and credit, it would seem that those 7,043 people never should have been included in the class. The record on appeal does not permit us to rule definitively on this point, however, and we shall assume that the California fund participants constituted a subclass in this litigation. Unless it was proper for the District Judge to enjoin Bestline from complying with those judgments, a question which is answered in the negative in part VI of this opinion, the District Court erred by not making the California group whole out of the settlement proceeds, or at least according them an absolute priority to all such funds. Furthermore, since those 7,043 people were already entitled to such funds (up to $4,500,000 plus interest), this litigation has generated no common fund from which to pay attorneys' fees and expenses.

Thus, the result which we reach, by assuming that the 7,043 California fund participants were properly included in the class as defined by the District Court, is the same as that which would have been reached if those persons had not been included in the class and if the preliminary injunction had not issued. By concluding that those persons are entitled to settlement proceeds up to $4,500,000 plus interest, they are placed in the same position they would have been in if Bestline had made all the scheduled payments to the trustee. If, however, Bestline would have defaulted on those payments before now, the California class would still have obtained Bestline's assets through liquidation long before this settlement.

Therefore, the order approving the Bestline settlement and entering final judgment as to the subscribing defendants is vacated in its entirety.

VI.

THE PRELIMINARY INJUNCTION

[16] In the face of Rule 52(a)'s requirement that courts set forth findings of fact and conclusions of law which form the grounds for granting interlocutory injunctions, and after having been clearly apprised of the barrier presented by 28 U.S.C. §2283 (the "Anti-Injunction Act"), both by briefs and oral argument, the District Judge brushed past the statute in the belief that it would be "inequitable" not to issue the injunction. Since the appeal in No. 76-3495 has not been dismissed, and since Bestline has represented to this Court that it would not move to dismiss if Sylva were allowed to intervene in No. 77-2045, we clearly have jurisdiction under 28 U.S.C. §1292(a)(1) to review the issuance of that injunction. We reverse.

The Anti-Injunction Act, the predecessor of which was enacted in 1793, has long been an important and integral part of our federal system. As amended in 1948, it now provides:

> A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments.

28 U.S.C. §2283. The Supreme Court has on many occasions explicitly declared that this statute must be given a strict construction due to the sensitive nature of federal interference with state court proceedings.

> On its face the present Act is an absolute prohibition against enjoining state court proceedings, unless the injunction falls within one of three

> specifically defined exceptions. The respondents here have intimated that the Act only establishes a "principle of comity," not a binding rule on the power of the federal courts. The argument implies that in certain circumstances a federal court may enjoin state court proceedings even if that action cannot be justified by any of the three exceptions. We cannot accept any such contention. . . . [We] hold that any injunction against state court proceedings otherwise proper under general equitable principles must be based on one of the specific statutory exceptions to §2283 if it is to be upheld. . . .

Mitchum v. Foster, 407 U.S. 225, 229, 92 S.Ct. 2151, 2155, 32 L.Ed.2d 705 (1972), quoting *Atlantic Coast Line R. Co. v. Brotherhood of Locomotive Engineers*, 398 U.S. 281, 286-87, 90 S.Ct. 1739, 26 L.Ed.2d 234 (1970). See also *Amalgamated Clothing Workers v. Richman Bros.*, 348 U.S. 511, 75 S.Ct. 452, 99 L.Ed. 600 (1955); *Carter v. Ogden Corp.*, 524 F.2d 74, 76 (5th Cir. 1975); *International Ass'n of Machinists & Aerospace Workers v. Nix*, 512 F.2d 125, 129 (5th Cir. 1975).

Furthermore, it has long been "settled that the prohibition of §2283 cannot be evaded by addressing the order to the parties or prohibiting utilization of the results of a completed state proceeding." *Atlantic Coast Line R. Co., supra*, 398 U.S. at 287, 90 S.Ct. at 1743, citing *Oklahoma Packing Co. v. Gas Co.*, 309 U.S. 4, 9, 60 S.Ct. 215, 84 L.Ed. 537 (1940), and *Hill v. Martin*, 296 U.S. 393, 403, 56 S.Ct. 278, 80 L.Ed. 293 (1935). In *Hill*, Justice Brandeis wrote as follows for a unanimous court:

> The prohibition of [§2283] is against a stay of "proceedings in any court of a State." That term is comprehensive. It includes all steps taken or which

> may be taken in the state court or by its officers from the institution to the close of the final process. It applies to appellate as well as to original proceedings; and is independent of the doctrine of *res judicata*. It applies alike to action by the court and by its ministerial officers; applies not only to an execution issued on a judgment, but to any proceeding supplemental or ancillary taken with a view to making the suit or judgment effective. The prohibition is applicable whether such supplementary or ancillary proceeding is taken in the court which rendered the judgment or in some other. And it governs a privy to the state court proceeding . . . as well as the parties of record. Thus, the prohibition applies whatever the nature of the proceedings . . . .

296 U.S. at 403, 56 S.Ct. at 282-283 (footnotes omitted). Although the plaintiffs make a feeble attempt to argue that the injunction did not stay "proceedings in a State court", *Hill* leaves absolutely no doubt that the scheduled payment of $500,000 to the trustee of an express trust set up by a judgment of the California Superior Court was, at the least, a "proceeding supplemental or ancillary taken with a view to making the suit or judgment effective." Therefore, we cannot accept this argument and proceed to determine whether the injunction can be justified by any of the three express exceptions.[27]

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[27]We do not consider the "protect or effectuate its judgments" exception for the simple reason that there was no judgment to protect when the injunction issued. *See Mitchum v. Foster*, 407 U.S. 225, 236 & n. 21, 92 S.Ct. 2151, 32 L.Ed.2d 705 (1972); *International Ass'n of Machinists & Aerospace Workers v. Nix*, 5 Cir. 1975, 512 F.2d 125, 129-33 (recognizing the federal court under this exception may enjoin "the relitigation in state court of issues that federal courts have fully and finally adjudicated").

A. *The "expressly authorized" exception*

[17, 18] The plaintiffs first argue that the injunction was "expressly authorized" by Fed.R.Civ.P. 23(d), and claim that the rule cannot insure the fair and efficient conduct of class actions unless injunctions are permitted against state court proceedings by absent class members. The trouble is that this argument was never presented to the District Court and there is no real reason to suppose that it formed the unexpressed rationale for its decision. Moreover, this Court has never held that Rule 23(d) is an express exception to 28 U.S.C. §2283, and we cannot accept that theory today. As stated in *Mitchum v. Foster*, 407 U.S. 225, 238, 92 S.Ct. 2151, 2160, 32 L.Ed.2d 705 (1972), "The test . . . is whether an act of Congress, clearly creating a federal right or remedy enforceable in a federal court of equity, could be given its intended scope only by the stay of a state court proceeding." Rule 23(d) is a rule of procedure and it creates neither a right nor a remedy enforceable in a federal court of equity. Thus, even under the expansive *Mitchum* test, which may not be quite as expansive as it seems,[28] this argument must fail.

Next, the plaintiffs claim that the injunction was authorized by 42 U.S.C. §1983, which the Supreme Court held in *Mitchum* to be one of the "expressly authorized" exceptions to §2283. Section 1983 speaks in terms of the "the deprivation of any rights, privileges, or immunities secured by the Constitution and laws," and if it were construed to mean *all* federal laws, then the exception would quickly swallow the rule set forth in §2283. *Cf. Chapman v. Houston Welfare Rights*

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[28]*See, e.g., Juidice v. Vail*, 430 U.S. 327, 341-47, 97 S.Ct. 1211, 51 L.Ed.2d 376 (1977) (Brennan, J., dissenting); *Huffman v. Pursue, Ltd.*, 420 U.S. 592, 613-18, 95 S.Ct. 1200, 43 L.Ed.2d 482 (1975).

Organization, 441 U.S. 600, 99 S.Ct. 1905, 60 L.Ed.2d 508 (1979) (Powell, J., concurring, asserting that the word "laws" in §1983 should be interpreted to mean laws providing for equal rights). This was not the result intended by the Supreme Court in *Mitchum*, as is evidenced by its direct progeny, *e.g.*, *Juidice v. Vail*, 430 U.S. 327, 97 S.Ct. 1211, 51 L.Ed.2d 376 (1977); *Huffman v. Pursue, Ltd.*, 420 U.S. 592, 95 S.Ct. 1200, 43 L.Ed.2d 482 (1975); as well as the case of *Vendo Co. v. Lektro-Vend Corp.*, 433 U.S. 623, 97 S.Ct. 2881, 53 L.Ed.2d 1009 (1977).

[19] In this case the plaintiffs allege that they have been deprived of two separate constitutional rights. First, they argue that they were somehow deprived of property without due process of law because they never received notice of the California proceedings. Those proceedings were instituted by the California attorney general on behalf of California residents against a California corporation alleging violations of California law. As to themselves, non-Californians were not bound by that judgment, and it cannot be thought that the Constitution required the attorney general to notify residents of other states of the institution of his lawsuit. The fact that Californians ultimately won a judgment against Bestline and began to recover has not deprived the plaintiff class of property without notice.

Second, the plaintiffs argue that they have been denied the equal protection of the laws because the California restitution fund denied participation solely on the basis of residence. This arguement is meritless, if not frivolous. In the first place, the Modified Judgment allows anyone with a judgment to participate in the restitution fund, and it does not differentiate on the basis of residence. Next, even if the judgment allowed

no persons outside California to participate, which it does not, there is no showing that this involved suspect classes, or fundamental interests or that it would be an arbitrary or irrational distinction; hence there could be no equal protection violation.

Although the plaintiffs have not articulated their arguments well, they could be advancing an assertion that Section 27 of the Securities Exchange Act, 15 U.S.C., Section 78aa, when coupled with the authority to issue injunctions and writs of mandamus contained in Section 21 of the Act, 15 U.S.C., Section 78u, constitutes an "expressly authorized" exception to Section 2283. The Second Circuit rejected a similar contention in *International Controls Corporation v. Vesco*, 490 F.2d 1334, 1349 (2d Cir., 1974); and we think that decision, at least insofar as it affects private lawsuits, compare *SEC v. Wencke*, 577 F.2d 619 (9th Cir., 1978), is eminently correct.

[20] There can be no doubt of this conclusion after the decision of the Supreme Court in *Vendo Co. v. Lektro-Vend Corp.*, 433 U.S. 623, 97 S.Ct. 2881, 53 L.Ed.2d 1009 (1977). In that case, three Justices concluded that §16 of the Clayton Act, 15 U.S.C. §26, did not constitute an express exception to the Anti-Injunction Act. Those three Justices concluded that the *Mitchum* decision, which held that 42 U.S.C. §1983 was an express exception to the Anti-Injunction Act, was based upon a "recognition that one of the clear congressional concerns underlying the enactment of §1983 was the possiblity that state courts, as well as other branches of state government, might be used as instruments to deny citizens their rights under the Federal Constitution." 433 U.S. at 633, 97 S.Ct. at 2888. They were unable to find such concerns in either the clear language or the legislative history of

the antitrust laws and therefore concluded that §16 of the Clayton Act was not such an exception. Two concurring Justices would have held "that no injunction may issue against currently pending state-court proceedings unless those proceedings are themselves part of a 'pattern of baseless, repetitive claims' that are being used as an anticompetitive device, all the traditional prerequisites for equitable relief are satisfied, and the only way to give the antitrust laws their intended scope is by staying the state proceedings." 433 U.S. at 644, 97 S.Ct. at 2894 (Blackmun, J., concurring). We are unable to find any Congressional concern in the language of the Securities Exchange Act that state courts might be used to deny individuals their rights under the Act, nor have we been pointed to any convincing legislative history to that effect. Nor can we ascertain any manner in which state court proceedings could be used to defeat the goals of the Securities Exchange Act. The California litigation was based upon violations of the state's deceptive advertising and unfair competition laws, which arguably are congruent in purpose with the Exchange Act and most assuredly do not defeat the purposes of that Act. Finally, the fact that 15 U.S.C. §78u is concerned entirely with the authority of the SEC to seek injunctions or other equitable relief strongly militates against any contention that it expressly authorizes a federal court to enjoin state court proceedings at the behest of private parties. Therefore, we conclude that for private lawsuits the Securities Exchange Act does not constitute an "expressly authorized" exception to 28 U.S.C. §2283. *See Vendo Co., supra*, 433 U.S. at 635-39 & n. 7, 97 S.Ct. 2881.

B. *The "in aid of its jurisdiction" exception*

The last argument advanced by the plaintiffs is that the District Court acted to protect its exclusive jurisdiction to adjudicate controversies arising under the Securities Exchange Act of 1934. *See* 15 U.S.C. §78aa. In *Carter v. Ogden Corp.*, 524 F.2d 74 (5th Cir. 1975), we considered and rejected a similar claim. In that case, Carter filed a suit in a Louisiana federal court alleging antitrust violations and a state law breach of contract claim. Ogden then filed suit in Delaware state court, and the Louisiana federal court enjoined Ogden from prosecuting any other suit. We reversed, noting that "[t]he phrase 'where necessary in aid of its jurisdiction,' . . . should be interpreted narrowly, in the direction of federal non-interference with orderly state proceedings." 524 F.2d at 76, *quoting T. Smith & Sons, Inc. v. Williams*, 275 F.2d 397, 407 (5th Cir. 1960). Finding no evidence that the Delaware proceedings would interfere with the jurisdiction of the Louisiana court to hear the case, we held that the grant of exclusive jurisdiction to federal courts to entertain antitrust actions had no impact on state law breach of contract claims.

In this case the plaintiffs have alleged violations of state law, the Securities Act of 1933, and the Securities Exchange Act of 1934. The federal courts have jurisdiction to entertain the state law claims only if diversity of citizenship is present or under the doctrine of pendent jurisdiction. The state and federal courts have concurrent jurisdiction to decide cases arising under the Securities Act of 1933, and no case originally brought in a state court of competent jurisdiction under that Act may be removed to a federal court. 15 U.S.C. §77v. Under the Securities Exchange Act of 1934, the federal district courts have exclusive jurisdiction to decide cases arising

under that act. 15 U.S.C. §78aa. Thus, in this case, the plaintiffs' argument seems to include the proposition that if they are correct in their assertion that the "in aid of its jurisdiction" exception applies because of the Exchange Act, then the District Court may enjoin state court prosecutions of either state law claims or of Securities Act claims, simply because such claims have been attached to a complaint alleging violations of the Exchange Act.

[21] The California litigation was based solely upon violations of state law, and it never purported to adjudicate a claim under the Exchange Act. Those proceedings in no way affected the "flexibility and authority" of the federal court to decide the Exchange Act claims. *See Atlantic Coast Line R. Co., supra*, 398 U.S. at 295, 90 S.Ct. 1739. The fact that Bestline might have fewer assets available to satisfy any judgment entered as a result of the Florida federal litigation in no way affects the jurisdiction of the federal court. Just as we rejected in *Williams, supra*, the claim that a federal district court may enjoin state court proceedings simply because it has before it a case arising under the antitrust laws, we reject the argument that a federal court may enjoin state court proceedings in order to decide a private lawsuit brought under the Securities Exchange Act of 1934.

SUMMARY

We summarize our holdings in this case, as follows:

1. Summary judgment should not have been entered.

2. Sylva was entitled to intervention as a matter of right.

3. The attorneys' fees as proposed in the Bestline settlement should not have been approved as presented.

4. The entry of an injunction against enforcement of the judgment of the California Superior Court is reversed.

5. The order entering final judgment as to Bestline and 27 individual defendants is vacated.

CONCLUSION

The Judgment of the District Court is reversed. The case is remanded for further proceedings not inconsistent herewith.

REVERSED and REMANDED.

APPENDIX

Chronology of Events in Bestline Litigation

July 22, 1970	FTC issues complaint against Bestline.
May 12, 1971	California files suit Bestline.
Nov. 3, 1971	Consent order with FTC becomes final.
Oct. 25, 1972	Trial begins in Cal. Superior Court.
June 13, 1973	Trial ends.
July 20, 1973	Piambino plaintiffs file class action in So. Dist. Florida.
July 23, 1973	Bestline files bankruptcy petition in N.D. California.
July 25, 1973	Cal. Superior Court issues written judgment and order, later stayed by N.D. California.
Dec. 21, 1973	Modified Judgment entered and Bestline withdraws bankruptcy petition.
Jan. 31, 1974	First payment made from restitution fund ($1,000,000).
May 3, 1974	Multidistrict panel first transfers cases to S.D. Florida.
June 30, 1974	Second payment made from restitution fund ($1,000,000).
Sept. 20, 1974	Lead counsel threaten Bank of America.
Oct. 8, 1974	Lead counsel threaten Bank of America.
Nov. 14, 1974	Cal. Superior Court orders payments to be made.
Nov. 15, 1974	Lead counsel file class action in N.D. California to enjoin payments.
Nov. 22, 1974	S.D. Florida certifies class.
Dec. 20, 1974	Multidistrict panel conditionally transfers N.D. California suit to S.D. Florida.
Jan. 1, 1975	Third payment made from restitution fund ($1,000,000).

APPENDIX—Continued

Chronology of Events in Bestline Litigation

Feb. 14, 1975	Multidistrict panel vacates previous order. Case returns to N.D. California.
March 28, 1975	Hearing held in N.D. California; plaintiffs fail to appear.
April 4, 1975	N.D. California dismisses complaint with prejudice.
June 30, 1975	Fourth payment made from restitution fund ($1,000,000).
Jan. 1, 1976	Fifth payment made from restitution fund ($250,000).
Feb. 23, 1976	Ninth Circuit dismisses appeal.
March 19, 1976	S.D. Florida grants motion for summary judgment.
April 2, 1976	N.D. California holds that Bestline has violated consent order.
June 30, 1976	S.D. Florida enjoins Bestline from bench; written order follows on July 7.
July 19, 1976	N.D. California enters judgment against Bailey.
Oct. 20, 1976	S.D. Florida approves Bailey settlement; money then transferred from N.D. California to S.D. Florida.
Feb. 25, 1977	S.D. Florida approves Bestline settlement and denies intervention.

Peter PIAMBINO and JOSEPH F. KUCKLICK, Plaintiffs-Appellees.

v.

William E. BAILEY and David L. Eastis, Defendants,

and

Bestline Products, Inc., a California corporation, Defendant-Appellee,

David Sylva, Intervenor-Appellant.

No. 82-5844.

United States Court of Appeals, Eleventh Circuit.

March 18, 1985.

* * *

Appeal from the United States District Court for the Southern District of Florida.

Before TJOFLAT and CLARK, Circuit Judges, and GOLDBERG*, Senior Circuit Judge.

TJOFLAT, Circuit Judge:

I.

This is a class action in which the plaintiffs seek money damages under the federal securities laws. The lawyers who have been representing the plaintiff-class have a conflict of interest with the minority segment of the class. They have used this conflict of interest to benefit themselves and the majority of the class members since the case began. On March 11, 1977, they concluded a settlement and obtained an attorney's fee award, both of which were highly unfair to the minority members.

We set aside the settlement and the fee award in *Piambino v. Bailey (Piambino I)*, 610 F.2d 1306 (5th Cir.),[1] *cert. denied*, 449 U.S. 1011, 101 S.Ct. 568, 66 L.Ed.2d 469 (1980), and instructed the district court to grant David R. Sylva the status of an intervening party plaintiff to protect the interests of these minority members of the plaintiff-class (the "Minority Group").

When the district court received our mandate, the plaintiff's lawyers resisted its enforcement because the proceeds of the vacated settlement had been disbursed and they had spent the attorney's fee the court had awarded them. Faced with this problem, the district court refused to enforce our mandate. Sylva now turns to us for relief.[2]

A brief synopsis of the events that led to our decision in *Piambino I* and thereafter took place in the

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[1]*Piambino I* was decided by our predecessor circuit, the former Fifth Circuit. On October 1, 1981, that circuit divided into the new Fifth Circuit and our Eleventh Circuit. Throughout this opinion we treat *Piambino I*, which is binding on this court, as if the Eleventh Circuit had decided it. In *Bonner v. City of Prichard*, 661 F.2d 1206, 1209 (11th Cir. 1981) (en banc), we adopted as binding precedent all decisions of the former Fifth Circuit handed down prior to October 1, 1981.

[2]We treat Sylva's appeal as a petition for a writ of mandamus pursuant to 28 U.S.C. §1651 (1982) because there is some question whether the district court's action in failing to follow our mandate constitutes a final judgment reviewable under 28 U.S.C. §1291 (1982). *See United States v. Haley*, 371 U.S. 18, 83 S.Ct. 11, 9 L.Ed.2d 1 (1962); *United States v. United States District Court*, 334 U.S. 258, 263, 68 S.Ct. 1035, 1037, 92 L.Ed. 1351 (1948); *United States v. Ritter*, 273 F.2d 30 (10th Cir. 1959), *cert. denied*, 362 U.S. 950, 80 S.Ct. 863, 4 L.Ed.2d 869 (1960); *cf. Baltimore & O.R. Co. v. United States*, 279 U.S. 781, 785, 49 S.Ct. 492, 493, 73 L.Ed. 954 (1929); *In re Sanford Fork & Tool Co.*, 160 U.S. 247, 255-56, 16 S.Ct. 291, 293, 40 L.Ed. 414 (1895).

district court is necessary to give context to the holdings of that decision, the serious legal and ethical questions this appeal presents, and our disposition of those questions.

A.

The plaintiffs in this case are purchasers of distributorships in a nationwide pyramid marketing scheme devised and operated by Bestline Corporation[3] to sell soap products. The plaintiffs became Bestline distributors, they allege, in reliance upon Bestline's representation that its distributors were making substantial profits and that they would also. This representation was false, and the plaintiffs lost their investments. They brought this class action, on July 20, 1973, against Bestline and its principals, contending that their distributorships were "securities" and seeking money damages under federal securities laws.

The plaintiffs comprising the Minority Group are the beneficiaries of a multimillion dollar state court judgment (the "California Judgment") the attorney general of California obtained against Bestline Corporation in 1973, about the time this litigation began, under California's consumer fraud laws. That judgment required Bestline to make periodic restitution payments into a fund (the "California Fund"), established by the judgment, for distribution Bestline's California distributors. David R. Sylva is the trustee of that fund; he is charged with the responsibility of approving the distributors' claims and forwarding Bestline's restitution payments to them.

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[3]Bestline Corporation, a California corporation, is the parent corporation of a wholly-owned subsidiary, Bestline Products, Inc., also a California corporation and also a defendant in many of the lawsuits discussed *infra*. These two entities will be referred to, collectively, as Bestline.

Soon after they filed the present class-action suit, if not before, it became evident to the plaintiffs' lawyers ("Lead Counsel") that Bestline would lack sufficient financial resources to make a significant settlement offer, or to satisfy any judgment the plaintiff-class might obtain after a trial on the merits, and to pay them an attorney's fee, if Bestline continued making restitution payments to their clients in the plaintiff-class who were beneficiaries of the California Judgment, *i.e.*, the Minority Group. Lead Counsel therefore took steps to stop the flow of money from Bestline to these clients.

First, Lead Counsel appeared before the Superior Court of Los Angeles County, whose judgment was providing the vehicle for Bestline's restitution payments, and requested that court to impose a constructive trust on the California Fund for the benefit of their clients in the plaintiff-class who were not beneficiaries of the California Judgment (the "Majority Group"). The Superior Court rejected Lead Counsel's request. Lead Counsel then brought suit in the U.S. District Court for the Northern District of California. They named as plaintiffs the entire plaintiff-class now before us (the Majority and the Minority Groups) and as defendants, among others, Sylva,[4] the Superior Court of Los Angeles County, and the California attorney general. Lead Counsel asked the district court to enjoin Sylva from distributing to the Minority Group the restitution funds Bestline was paying into the California Fund on the grounds, *inter alia*, that the California Judgment, by not providing for

[4]H. Lee Holden, Sylva's predecessor as trustee of the California Fund, was actually named as defendant. When Sylva replaced Holden as trustee he was substituted as the proper party defendant.

restitution to the Majority Group, denied the members of that Group rights secured by the ninth[5] and fourteenth[6] amendments to the U.S. Constitution. The district court refused to grant the injunction and dismissed the case, with prejudice, for failure to state a claim for relief.[7] *See* Fed.R.Civ.P. 12(b)(6).

Having failed in California, Lead Counsel turned to the district court below for relief. The district court had previously determined, on plaintiffs' motion for summary judgment, that the distributorships plaintiffs had purchased from Bestline were securities within the meaning of the federal securities laws, and the parties were in the process of preparing for trial. On June 18, 1976, Lead Counsel moved the court to enjoin Bestline Corporation from making a $500,000 restitution payment to the California Fund that was due on June 30. In urging the court to issue the injunction, they pointed out that Bestline was rapidly disposing of its

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[5]The ninth amendment to the U.S. Constitution provides that "[t]he enumeration in the Constitution, of certain rights, shall not be construed to deny or disparage others retained by the people."

[6]Section One of the fourteenth amendment to the U.S. Constitution provides that:

> All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

[7]The court made its ruling in an unpublished memorandum order.

assets and that, unless the court took action, Bestline would soon have no assets to pay the plaintiffs' claims. On June 30, the district court preliminarily enjoined Bestline from making the payment due that day and ordered it to deposit the sum of $500,000 in the registry of the court. The court further enjoined Bestline from making any subsequent payment called for by the California Judgment.

Bestline objected to the issuance of this injunction on the ground, *inter alia*, that the court had not required the plaintiffs to post a bond as required by Fed.R.Civ.P. 65(c).[8] In response, the court said that Bestline's $500,000 deposit would serve as the plaintiffs' bond and would remain in the court's registry as long as the injunction remained in effect.

Bestline immediately appealed the district court's injunctive order to this court. While Bestline's appeal was pending, Lead Counsel negotiated a settlement with Bestline and twenty-seven of the individual defendants. On January 28, 1977, the district court preliminarily approved the settlement. Two weeks later, Sylva moved the court to intervene as a party plaintiff, representing the Minority Group. He requested the court to designate that Group a plaintiff-subclass, claiming that Lead Counsel's representation of both the Majority and the Minority Groups constituted a conflict of interest.

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[8] Fed.R.Civ.P. 65(c) provides:

> (c) **Security.** No restraining order or preliminary injunction shall issue except upon the giving of security by the applicant, in such sum as the court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained. No such security shall be required of the United States or of an officer or agency thereof.

Sylva sought to intervene for two reasons: to seek the vacation or modification of the injunction that was preventing Bestline from fulfilling its obligations under the California Judgment, and to contest the settlement the court had preliminarily approved. Sylva objected to the settlement because most of the members of the Minority Group would not share in the proceeds thereof and because, under its terms, Bestline would be precluded from making further restitution to that Group under the California Judgment.

The district court entertained Sylva's motion to intervene on March 11, 1977, at a hearing on Lead Counsel's application for the final approval of the aforementioned settlement and the award of an attorney's fee and expenses. The court denied Sylva's motion as untimely and meritless, without further explication. It then addressed the propriety of the settlement and the issue of Lead Counsel's attorney's fee and litigation expenses. The court approved the settlement as "fair, reasonable and adequate" and, stating that there were no objections, approved Lead Counsel's request for a $750,000 attorney's fee and $50,000 in expenses. Three days later, the clerk of the court disbursed the fee to Lead Counsel out of funds on deposit in the court's registry.

On April 1, 1977, Sylva took an appeal from the district court's order denying his motion to intervene; at the same time, he moved the district court to stay the execution of the settlement and to set aside the attorney's fee the clerk had disbursed to Lead Counsel. The district court, on May 2, 1977, refused to set aside the fee disbursement or to grant the stay, and, by the time we heard Sylva's appeal, the district court had disbursed all of the settlement proceeds to the eligible members of the plaintiff-class.

B.

On December 5, 1980, we decided *Piambino I*, 610 F.2d 1306 (5th Cir.), *cert. denied*, 449 U.S. 1011, 101 S.Ct. 568, 66 L.Ed.2d 469 (1980), Sylva's appeal and Bestline's earlier appeal from the district court's preliminary injunction,[9] which had been consolidated for argument and decisional purposes.[10] We reversed the district court's order enjoining Bestline from making the restitution payments called for by the California Judgment, because that order had no basis in law. *Id.* at 1334. We also reversed the district court's order denying Sylva intervention, concluding that the court should have allowed him to intervene in behalf of the Minority Group because its interests were at odds with those of the Majority Group and were not being adequately represented by Lead Counsel. Accordingly, we instructed the district court, on remand, to treat Sylva as a party plaintiff.

Most of the factors that counseled our decision on the intervention issue made clear the unfairness of the settlement. We therefore vacated the settlement. Having

[9]Although the settlement between Bestline and the plaintiff-class would have ordinarily mooted Bestline's appeal, *see United Airlines, Inc. v. McDonald*, 432 U.S. 385, 400, 97 S.Ct. 2464, 2473, 53 L.Ed.2d 423 (1977), the possibility that Sylva might be permitted to intervene, as the representative of the Minority Group, to contest the validity of the injunction, the settlement, and Lead Counsel's attorney's fee and expense award kept the controversy alive and ripe for appellate review.

[10]In its notice of appeal, Bestline also sought review of the district court's partial summary judgment which determined that Bestline's distributorships were securities. The partial summary judgment was not appealable. *See infra* note 56. This point, however, is not germane to this appeal.

taken this action, we could not allow the district court's award of an attorney's fee and expenses to stand; accordingly, we set it aside as well.

Our decision in these consolidated appeals swept beyond the foregoing issues and reached the district court's summary judgment determination that Bestline's distributorships constituted securities. We found a genuine issue of material fact as to whether these distributorships were securities and thus vacated that ruling. In sum, we restored the *status quo ante*. We anticipated that, following the issuance of the mandate, the case would go forward in the district court as if the parties had just joined issue and Sylva had intervened as a party plaintiff, representing the Minority Group.

What we anticipated would occur in the district court has not transpired, however. Rather, Lead Counsel have attempted to avoid the consequences of our decision in order to preserve the settlement and their award of a fee and expenses. They have been so motivated because the settlement proceeds have been disbursed and their fee has been "spent."[11] Bestline and the twenty-seven individual settling defendants have also attempted to preserve the settlement. Bestline, whose assets have been liquidated as required by the settlement, has tended to be indifferent. The twenty-seven individual defendants, however, have been far from indifferent. If the district court were to treat their settlement as a nullity and they had to proceed to trial, they would be exposed to substantial liability and, moreover, would have to finance their defense of the case. The defendants have therefore joined ranks with Lead Counsel in their attempt to preserve the settlement they made.

[11]Lead Counsel informed us of this fact during the oral argument of this appeal.

Lead Counsel's first step in pursuit of this goal was to move the district court to amend its original class certification order to eliminate the Minority Group; with that Group out of the case, Lead Counsel and the defendants could recast their settlement and present it to the court for approval. While this motion was pending, the district court, acting *sua sponte*, issued an order on our mandate. The order followed the letter of the mandate with one exception; it refused to grant Sylva intervention as a party plaintiff. The court then granted Lead Counsel's pending motion, severing the Minority Group from the plaintiff-class. Sylva, upon learning of the entry of these two orders, moved the court to grant him intervernor status *instanter*, as directed by our mandate. He also moved the court to order the plaintiffs and Lead Counsel to transfer to the California Fund the monies they had received as a result of the settlement, contending that such action was mandated. The district court denied Sylva's motion in its entirety, and Sylva perfected this appeal.

C.

Sylva presents two claims of error. He contends, first, that our mandate required the district court to grant him immediate status as an intervenor, representing the Minority Group, and that the district court could not avoid this obligation. Second, he contends that the mandate, by clear implication, required the district court to order Lead Counsel and the members of the plaintiff-class who shared in the settlement to pay to the California Fund all of the monies they have received, including the $500,000 June 30, 1976 restitution payment the district court enjoined Bestline to deposit in the registry of the court.

Lead Counsel, appearing solely in behalf of the Majority Group since the Minority Group has been severed from the plaintiff-class, contend in response that our mandate does not call for the relief Sylva seeks. With respect to Sylva's first point, Lead Counsel argue that we did not grant Sylva intervention; rather, we held that Sylva's motion to intervene had been timely and meritorious but left it to the district court to determine whether the motion met the procedural requirements of Fed.R.Civ.P. 24(c).[12] They suggest that the district court refused to grant Sylva intervention because his motion for leave to intervene failed to meet those procedural requirements.

With respect to Sylva's second claim of error, Lead Counsel argue, alternatively, that our mandate did not contemplate a return of the monies paid out in connection with the settlement, and that, if it did, we should not enforce the mandate because it has no basis in law and is manifestly unjust. Bestline and the twenty-seven individual defendants join in Lead Counsel's arguments and urge us to affirm the district court.

We reverse. We hold as follows: First, *Piambino I*, and its mandate, correctly obligated the district court to grant Sylva intervention as a party plaintiff, representing the Minority Group. The district court's refusal to grant such intervention and its later action in deleting the Minority Group from the plaintiff-class violated that provision of the mandate.

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[12]Fed.R.Civ.P. 24(c) provides in pertinent part:

> (c) **Procedure.** A person desiring to intervene shall serve a motion to intervene upon the parties as provided in Rule 5. The motion shall state the grounds therefor and shall be accompanied by a pleading setting forth the claim or defense for which intervention is sought.

Second, the *status quo ante* the *Piambino I* panel clearly intended cannot be achieved if those who participated in the settlement retain the monies they have received. We therefore instruct the district court, upon receipt of the mandate that issues with our decision in this appeal, to order the plaintiffs and Lead Counsel to pay such monies into the district court's registry.

Third, Lead Counsel, having a patent and substantial conflict of interest not only with Sylva and the Minority Group but with the Majority Group as well, are disqualified from representing any party in this case, save themselves. We set forth our reasons for these holdings *seriatim*, in Parts II.A., B., and C below.

II.

[1, 2] A trial court, upon receiving the mandate of an appellate court, may not alter, amend, or examine the mandate, or give any further relief or review, but must enter an order in strict compliance with the mandate. *In re Sanford Fork & Tool Co.*, 160 U.S. 247, 255, 16 S.Ct. 291, 293, 40 L.Ed. 414 (1895). The trial court must implement both the letter and the spirit of the mandate, *Nixon v. Richey*, 513 F.2d 430, 435-36 (D.C. 1975), *aff'd on other grounds*, 433 U.S. 425, 97 S.Ct. 2777, 53 L.Ed.2d 867 (1977); *Reserve Mining Co. v. Environmental Protection Agency*, 514 F.2d 492, 541 (8th Cir.1975) (en banc), taking into account the appellate court's opinion, *In re Sanford Fork & Tool Co.*, 160 U.S. at 256, 16 S.Ct. at 293 (1895); *Cherokee Nation v. Oklahoma*, 461 F.2d 674, 678 (10th Cir.), *cert. denied*, 409 U.S. 1039, 93 S.Ct. 521, 34 L.Ed.2d 489 (1972), and the circumstances it embraces. *Sherwin v. Welch*, 319 F.2d 729, 731 (D.C.Cir.1963). Although the trial court is free to address, as a matter of first impression, those issues not disposed of on appeal, *Holcomb v. United States*, 622 F.2d 937,

940 (7th Cir.1980); *see also, Dorsey v. Continental Casualty Co.*, 730 F.2d 675, 678, 679 (11th Cir. 1984), it is bound to follow the appellate court's holdings, both expressed and implied. *Cherokee Nation*, 461 F.2d at 678; *see also* 1B J. Moore, J. Lucas, & T Currier *Moore's Federal Practice* ¶0.404[10] (2d ed. 1984). If the trial court fails fully to implement the mandate, the aggrieved party may apply to the appellate court for enforcement, by petitioning for a writ of mandamus.[13]

[3] The "mandate rule," as it is known, is nothing more than a specific application of the "law of the case" doctrine. *Greater Boston Television Corp. v. Federal Communications Commission*, 463 F.2d 268, 279 (D.C.Cir.1971), *cert. denied*, 406 U.S. 950, 92 S.Ct. 2042, 32 L.Ed.2d 338 (1972); *City of Cleveland v. Federal Power Commission*, 561 F.2d 344, 348 (D.C.Cir.1977). This doctrine stands for the proposition that an appellate decision on an issue must be followed in all subsequent trial court proceedings unless the presentation of new evidence or an intervening change in the controlling law dictates a different result, or the appellate decision is clearly erroneous and, if implemented, would work a manifest injustice. *Westbrook v. Zant*, 743 F.2d 764, 768-69 (11th Cir. 1984); *Baumer v. United States*, 685 F.2d 1318, 1320 (11th Cir. 1982) (quoting *White v. Murtha*, 377 F.2d 428, 431-32 (5th Cir. 1967)).

[4,5] The law of the case doctrine is not an "inexorable command," *White v. Murtha*, 377 F.2d at 431, but rather a salutary rule of practice designed to bring an end to litigation, *id.*, discourage "panel shopping," *Lehrman v. Gulf Oil Corp.*, 500 F.2d 659, 662 (5th Cir.1974), *cert. denied*, 420 U.S. 929, 95 S.Ct. 1128, 43 L.Ed.2d 400

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[13]*See supra* note 2.

(1975), and ensure the obedience of lower courts. *United States v. Williams*, 728 F.2d 1402, 1406 (11th Cir.1984). As with the mandate rule, the law of the case doctrine applies to all issues decided expressly or by necessary implication; it does not extend to issues the appellate court did not address. *Terrell v. Household Goods Carriers' Bureau*, 494 F.2d 16, 19 (5th Cir.), *cert. dismissed*, 419 U.S. 987, 95 S.Ct. 246, 42 L.Ed.2d 260 (1974); *Fogel v. Chestnutt*, 668 F.2d 100 (2d Cir.1981), *cert. denied*, 459 U.S. 828, 103 S.Ct. 65, 74 L.Ed.2d 66 (1982). With these legal principles in mind, we turn to the holdings we reach in this appeal.

A.

[6] Sylva contends that our decision in *Piambino I* explicity gave him intervenor status and that the district court, on receipt of our mandate, should have accorded him such status without further consideration. Lead Counsel contend, in response, that our decision did not conclusively adjudicate Sylva's right to intervention; rather, it left to the district court the task of determining whether Sylva's motion to intervene met all of the procedural requirements for intervention prescribed by Fed.R.Civ.P. 24(c) and thus should be granted.[14] Lead Counsel suggest that the district court has now made this determination, concluding that Sylva failed to comply with Rule 24(c) because he did not file with his motion to intervene a separate pleading setting forth the claims he desired to prosecute, and has properly denied Sylva's motion. Although the court did not cite

[14]The *Piambino I* panel found, in addressing the question of Sylva's intervention, that he had a genuine and significant stake in the controversy and met the real party in interest requirements of Fed.R.Civ.O. 17(a). *Piambino I*, 610 F.2d at 1322-23. No one questions the correctness of this determination.

this procedural failure, or any other reason, for its ruling, we will assume, for discussion purposes, that the court based its ruling on such failure.

Sylva's failure to file a separate pleading setting forth his claims for relief could not have justified the district court's departure from this court's decision in *Piambino I* that Sylva be accorded intervention as a matter of right. As we have stated, the law of the case doctrine extends to every issue the reviewing court has decided, both explicitly and by necessary implication. Although our opinion did not explicitly address the procedural requirements of Rule 24, its command that Sylva be allowed to intervene necessarily implied that any procedural noncompliance with Rule 24 on his part was inconsequential. *Accord Walston v. School Board of City of Suffolk*, 566 F.2d 1201, 1205 (4th Cir.1977) (appellate court's determination that school teacher was entitled to various remedies for the discriminatory practices of her employer implied that her failure properly to name herself as party plaintiff would not justify dismissal of her action on remand); *Fogel v. Chestnutt*, 668 F.2d at 105, 108-09 (appellate court's determination that defendants were liable to private plaintiffs for damages under the Investment Company Act implied that there existed under that act a private right of action).

The conclusion that we did not comtemplate a subsequent district court resolution as to the procedural adequacy of Sylva's motion to intervene does not end the matter, however. We must now proceed one step further and decide whether the district court's refusal to follow our mandate, though not explained, could have been based on any of the exceptions to the law of

the case doctrine we have mentioned. *See supra* text at 11.20

The district court's refusal could not have been based on the first exception, new evidence, because the parties presented no new evidence on the intervention issue. The second exception, involving an intervening change in the controlling law, could not have applied, because the law has not changed. The court could not have invoked the third exception, because our decision that Sylva was entitled to intervene as a matter of right was not clearly erroneous and, when implemented, will not work a manifest injustice. Our decision was not clearly erroneous, we are convinced, because Sylva's motion was timely and had merit, and his failure to file a pleading in the nature of a complaint as required by Rule 24(c) was inconsequential. Lead Counsel concede, as they must, the timeliness and merit of Sylva's motion; their argument is that we committed clear error, and created a manifest injustice, in attaching no legal significance to Sylva's procedural default.

Rule 24(c) requires that a motion to intervene shall be accompanied by a pleading setting forth the claim or defense the movant seeks to present. Some courts of appeals have denied intervention to movants who have failed strictly to heed the requirements of Rule 24(c), *see, e.g., Abramson v. Pennwood Investment Corp.*, 392 F.2d 759, 761-62 (2d Cir.1968), but the majority of circuits, including this circuit, has not, choosing instead to disregard nonprejudicial technical defects. *Farina v. Mission Investment Trust*, 615 F.2d 1068, 1075 (5th Cir.1980) (court treats motion to remove as motion to intervene, noting that a contrary position would render federal pleadings excessively technical contrary to Fed.R.Civ.P.8(e)(1) and 8(f)). *See also, e.g., Howse v. S/V*

"Canada Goose I", 641F.2d 317, 319 & n. 1 (5th Cir.1981); *Spring Construction Co. v. Harris*, 614 F.2d 374, 376-77 (4th Cir.1980).

Sylva's failure to annex a complaint to his motion to intervene could not possibly have prejudiced the plaintiff-class or the defendants in this case. Everyone knew the nature of Sylva's substantive claims for relief; they were the very claims Lead Counsel had asserted in their complaint. Sylva sought intervention not to prosecute different, or additional, claims against the defendants, but only to protect the minority members of the plaintiff-class; Lead Counsel, he argued, were not properly representing the interests of these members.

Lead Counsel point out that Sylva also wanted the court to lift the injunction that had stopped the flow of restitution payments from Bestline to the California Fund and thus had a new claim to present. We do not view this ground for intervening as an additional claim, however; Sylva was merely renewing Bestline's previously articulated objection to the injunction. Even if we were to treat it as a new claim, we would have to conclude that Sylva satisfied Rule 24(c)'s separate pleading requirement because his motion to intervene, and the accompanying papers, clearly spelled out his position on the propriety of the injunction. An additional "pleading," which merely replicated these documents, would have been surplusage.

In sum, our *Piambino I* decision to accord Sylva intervention, though he had not filed a separate pleading containing his claims for relief, was not clearly erroneous. Moreover, that decision, when finally implemented, will not work a manifest injustice. In fact, the contrary is true; if the decision is not implemented, we will have worked manifest injustice on the Minority Group.

We therefore instruct the district court, on receipt of our mandate, to accord Sylva intervenor status *instanter*. It necessarily follows that the district court shall treat its order severing the Minority Group from the plaintiff-class, as void *ab initio*.

B.

Sylva contends that *Piambino I*, by clear implication, calls for Lead Counsel and the plaintiffs who shared in the settlement tc pay over to the California Fund all the monies they have received, including the $500,000 bond (posted pursuant to Fed.R. Civ.P. 65(c) after the district court enjoined Bestline's restitution payments to the Fund) which the court erroneously dissolved and turned over to Lead Counsel and the plaintiffs. Lead Counsel and the defendants, in response, argue that *Piambino I* cannot be read in this manner. They argue, alternatively, that, if it is, such a reading would amount to clear error and will lead to manifest injustice. We should therefore invoke the third exception to the law of the case doctrine and refuse to enforce the mandate.

As we have indicated in the summary of our holdings, *see supra* text at 1119, the *Piambino I* panel, in setting aside the settlement and the attorneys' fee award and in granting Sylva intervention, intended to achieve the *status quo ante*. Obviously, that status could not be achieved if Lead Counsel and the plaintiffs who participated in the settlement retain the monies they have received. We therefore conclude that implicit in the panel's decision is the holding that the district court order these recipients to restore such monies to the court's registry.

This holding is implicit for several reasons. First, the settlement was the product of an unlawful injunction.

Without the injunction, Bestline would have satisfied the California Judgment and would have had few, if any, resources remaining to devote to this case. Second, the settlement was patently unfair to the Minority Group. Lead Counsel and the settling defendants, acting in concert, created the settlement proceeds and the monies used to pay Lead Counsel's fee and expenses principally out of Bestline resources that, absent Lead Counsel's intervention, would have gone to the Minority Group; moreover, they prevented that Group from sharing in those proceeds equally with the other members of the plaintiff-class. Third, the settlement was patently unfair even to the other members of the plaintiff-class, because, as the *Piambino I* panel observed, the settlement provided for the payment to Lead Counsel of a substantial attorney's fee and expenses (out of funds that, presumably, would have gone to the plaintiff-class) even though the litigation generated "no common fund from which to pay attorneys' fees and expenses." *Piambino I*, 610 F.2d at 1330. Fourth, the negotiation and subsequent judicial approval of the settlement was markedly tainted by, if not the direct result of, a stark conflict of interest between Lead Counsel and his clients in the Minority Group. Fifth, to allow Lead Counsel and the plaintiffs for whose benefit the settlement was crafted to retain the fruits of the settlement under the circumstances presented here would seriously disparage the rule of law.

We are also convinced that the district court could not, and cannot now, refuse to implement *Piambino I*'s implied holding—that the fruits of the settlement be paid into the district court's registry—under any of the three exceptions to the law of the case doctrine. The first exception, that new evidence justifies a departure from the appellate court's decision, is

inapplicable because there was, and is, no new evidence, save Lead Counsel's announcement that the money has been spent. The second exception cannot come into play because there has been no change in the controlling law that would counsel a result different from that reached in *Piambino I*. The third exception, the one Lead Counsel would invoke, could not, and through the passage of time cannot, be relied upon; making Lead Counsel and the plaintiffs return the monies they have received is not a clearly erroneous decision and will not work a manifest injustice. This conclusion becomes inescapable when one examines the magnitude of Lead Counsel's conflict of interest in this case and the casual relationship between that conflict of interest and the critical, and substantial, errors the district court made to the detriment of Sylva and the Minority Group.

We begin our examination by revisiting in greater detail than we have some of the events that took place before this litigation began and the bold facts which put Lead Counsel on actual notice that they had a substantial conflict of interest with their own clients in this case, the Minority Group. We then describe how Lead Counsel expoited this conflict. Finally, we deal with the question of whether it would be clear error and manifestly unjust to require Lead Counsel and the plaintiffs to pay the monies they have received into the registry of the district court.

1.

The history of Bestline Corporation and its promoters has been reported extensively. *See, e.g., Piambino I, supra; United States v. Bestline Products Corporation*, 412 F.Supp. 754 (N.D.Cal.1976); *People v. Bestline Products, Inc.*, 61 Cal.App.3d 879, 132 Cal.Rptr. 767 (1976). We

repeat that history to the extent necessary to place our holdings, those in *Piambino I* and those we reach today, in perspective.

Bestline was organized in 1966 by William E. Bailey and Jerry Brassfield for the purpose of manufacturing and selling soap products for home use. Both Bailey and Brassfield had considerable experience in marketing consumer products through pyramid distribution systems,[15] and they formed a "pyramid" system[16] to distribute Bestline's products. At the bottom of the pyramid were "local distributors" who paid nothing for their distributorships.[17] They bought Bestline's products at 70% of the retail price and sold them to consumers, thus making a gross profit of 30%.[18] Local distributors were mostly housewives who were looking for a way to supplement the family income with part-time work. They usually sold their products to friends and neighbors who would gather for a demonstration party at the distributors' homes.

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[15]One of the companies they had been involved in was Holiday Magic, Inc., itself the subject of litigation similar to the Bestline litigation. See *Marshall v. Holiday Magic, Inc.*, 550 F.2d 1173 (9th Cir. 1977).

[16]*See generally* Note, *Pyramid Schemes: Dare to be Regulated*, 61 Geo.L.J. 1257 (1973), for an overview of pyramid sales schemes and the attempts made by both the federal and state governments to regulate or prohibit such schemes.

[17]They were required to pay a nominal sum of $5 annually as dues.

[18]A local distributor could receive an additional discount, in the form of a rebate, if his monthly sales exceeded $4,800. This fact is not material to the issues before us.

At the next level of the pyramid were "direct distributors." They paid Bestline approximately $3,000[19] for their distributorship.[20] For that payment, they were entitled to receive Bestline's soap products with a retail value of $5,000, which they could sell directly to consumers or to local distributors. They were also entitled to purchase additional products from Bestline, for similar resale, at 48% of the retail price.

At the top of the pyramid were "general distributors." They were former direct distributors who had recruited for Bestline two other direct distributors and paid Bestline $600, ostensibly to help Bestline offset the cost of operating its general distributors school which they were never required to attend.[21] General distributors were entitled to purchase Bestline products at 40% of the retail price and to sell them to consumers or to local or direct distributors. They were also entitled to continue recruiting direct distributors. For each direct distributorship a general distributor sold, Bestline paid him a $400 commission.[22] A general distributor therefore

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[19]This price varied over time but never fell below $3,000.

[20]One could also become a direct distributor by first becoming a local distributor and then selling at least $5,600 in retail value of Bestline products in one month. These were known as "work-in" direct distributorships. This path to direct distributorship was far less common, however, than the straight cash purchase of such distributorships.

[21]One could also become a general distributor by recruiting one other direct distributor and generating a sales volume of $5,000 in a single month. As with the "work-in" direct distributorship, *see supra* note 20, this was a far less common method of advancement.

[22]This $400 was equivalent to the difference between the general distributor's discount (60%) and the direct distributor's discount (52%) on the $5,000 worth of products which a direct

needed to sell nine direct distributorships or $6,000 worth of soap products to recoup his $3,600 investment. Considering that the typical home sales party usually grossed no more than $75 to $100 in sales, it would take a general distributor, operating at a 60% profit margin, from a year to a year and a half, at a party a week, to recoup his initial investment. A direct distributor, operating at a 48% profit margin, would take about the same amount of time to recoup his investment.

(Footnote 22 Continued)

distributor was entitled to take delivery of when he purchased his direct distributorship. Thus, Bestline attempted to make it appear that it was not compensating distributors for recruiting other distributors. The fact that direct distributors were never required to take delivery of the products they "purchased" with their initial $3,000 investment, *see infra* text at 1125, belies this fact.

In addition to this commission, Bestline created another means by which it compensated general distributors for recruiting others to become direct distributors, known as the "Special Incentive Bonus." To be eligible for the bonus, a general distributor, or those in the general distributor's pyramid (i.e., direct or local distributors whom he had recruited) were required to generate at least $36,000 of "product movement." Although "product movement" included sales of Bestline products to the public or the sales of such products between distributors at different levels in the pyramid, it consisted primarily of the "sale" of products by a general distributor to a direct distributor at the time the direct distributorship was purchased. Again, a general distributor was considered to have "sold" or generated $5,000 worth of product movement regardless of whether the direct distributor actually took delivery of the products. Bestline paid a general distributor a 3.3% commission on all product movement if he generated from $36,000 to $200,000 worth of product movement and a 15% commission on all product movement if he generated over $200,000 of product movement. Each direct distributor recruited who later rose to the level of general distributor generated about $15,000 worth of product movement.

It proved to be well nigh impossible for a general or direct distributor to make any money selling soap. They thus devoted their time and efforts to selling direct distributorships which they believed would net them substantial commissions. Bestline encouraged them to sell such distributorships rather than soap products because Bestline could earn far more from the sale of distributorships than from the sale of soap products. Bestline's profits were even greater if a direct distributor, after paying Bestline for his distributorship, chose not to take delivery of the soap to which he was entitled, for in such a case Bestline made a profit of at least $2,600.[23] It was not at all uncommon for a direct distributor to request that none of his soap products be delivered.

Most direct distributorships were sold at "Opportunity Meetings." These meetings, of which dozens, perhaps even hundreds, were held daily throughout the United States, typically took place in large hotel meeting rooms in the evening. Although these meetings were staged by Bestline, the general and direct distributors, who were dependent upon their success, provided the prospective purchasers and the majority of the financing for the meetings. Bestline showed these prospects how a Bestline distributor could earn a five or six figure annual income even in his spare time by recruiting other distributors. Bestline further represented that the supply of future distributors was inexhaustible. Invariably, several distributors would appear on the program to bear witness to these representations.

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[23] This is equivalent to the direct distributor's initial investment of $3,000 less the $400 commission Bestline was required to pay his sponsoring general distributor.

Bestline's representations were false. Few of those who purchased direct distributorships ever rose to the level of general distributor, and few of those who achieved general distributorship status ever recouped their investment, much less earned substantial profits.[24] Bestline's representation that there was an endless supply of potential distributors was also false. As a community became saturated with Bestline distributors, a distributor's chance of recovering any of his investment diminished.

Unlike the plight of the majority of its distributors, Bestline and its principals prospered. Bestline's sales organization expanded to all fifty states and several foreign countries. Top executives received handsome six figure salaries and enjoyed such perquisites as access to the company yacht and aircraft. As Bestline's pyramids grew, it produced more and more dissatisfied distributors. Many turned to the Federal Trade Commission and to state and local consumer protection agencies for relief.

The Federal Trade Commission (FTC) was the first to take formal action. On July 22, 1970, the FTC commenced administrative proceedings against Bestline

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[24]The California Court of Appeals, in *People v. Bestline Products, Inc.*, 61 Cal.App.3d 879, 132 Cal.Rptr. 767, 775 (1976), found that 87% of the direct distributors recruited in California from January 15, 1971, through November 30, 1972, never rose to the level of general distributor. And of those who did rise to the level of general distributor, 80.7% received commissions and bonuses of less than $5000, with the median being less than $1,000. The court concluded that "most of the new direct and general distributors did not even recoup the investment they made to acquire the initial inventory." *Id.*

and William E. Bailey[25] under 15 U.S.C. §45(b) (1982).[26] In its complaint, the FTC charged Bestline with operating an unfair and deceptive multilevel marketing plan under which persons were lured into purchasing distributorships by the promise of large financial rewards, when in fact such rewards depended on a "virtually, endless recruiting of participants into the scheme" and were "necessarily predicated on the exploitation of others who [had] virtually no chance of receiving a return on their investment."[27] Although refusing to admit that the acts and practices condemned in FTC's complaint violated any laws, Bestline and Bailey consented to the entry of a cease and desist order under which Bestline would abandon its pyramid marketing scheme.[28]

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[25]The FTC also proceeded against Robert W. Depeu, another Bestline officer. Depeu subsequently left Bestline, however, and the FTC dropped him from the case.

[26]15 U.S.C. §45(b) provides in pertinent part:

> Whenever the [FTC] shall have reason to believe that any such person, partnership, or corporation has been or is using any unfair method of competition or unfair or deceptive act or practice in or affecting commerce, and if it shall appear to the [FTC] that a proceeding by it in respect thereof would be to the interest of the public, it shall issue and serve upon such person, partnership, or corporation a complaint stating its changes in that respect. . . .

[27]The FTC's description of Bestline's scheme is more fully set forth in *United States v. Bestline Products Corp.*, 412 F.Supp. 754, 759 (N.D.Cal. 1976).

[28]Specifically, the cease and desist order prohibited Bestline from: (1) operating a program where financial gains were dependent upon the successive recruitment of others; (2) paying bonuses or commissions for the recruitment of others; (3) paying bonuses or

At the same time the FTC was proceeding administratively against Bestline, the attorney general of the state of California, acting in the name of the people of California, brought suit against Bestline and several of its principals, including Bailey, in California state court, seeking relief similar to that sought by the FTC. Settlement negotiations ensued. Subsequently, the defendants entered into a consent decree with the State whereby they agreed to cease operating their pyramid scheme and making false representations about a Bestline distributor's prospects of success.

Despite the entry of this consent decree, Bestline continued to market its product as it had in the past, thus prompting the California attorney general to seek stronger measures. On May 12, 1971, the attorney general, acting for the benefit of Bestline's California distributors, filed suit in the Superior Court of Los Angeles County against Bestline and Bailey and several other Bestline

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(Footnote 28 Continued)

commissions in connection with the sale of products unless the recipient performs a bona fide supervisory, distributive or selling function and the products are actually delivered to the buyer; (4) requiring participants to purchase products or pay other consideration beyond the actual cost of necessary sales materials; (5) using a scheme wherein profits are dependent on chance rather than skill; (6) using a scheme that fails to inform participants that all contracts for participation may be cancelled within three days; (7) representing the amount of money a participant might earn; (8) representing that it is not difficult to recruit others; (9) representing that it is easy to move up the ladder of distributorships; (10) representing that all participants will succeed; (11) representing that the supply of new recruits is inexhaustible; and (12) failing to disclose the terms of the cease and desist order to prospective distributors.

officers under California's consumer fraud laws.[29] The attorney general sought several forms of relief. First, he asked the court to enjoin Bestline from operating its pyramid scheme. Second, he sought restitution from Bestline for the losses the California direct distributors had sustained as a result of their purchases of direct distributorships. Third, he sought the imposition of civil penalties. The case went to trial, and the court found against the defendants. In its final judgment, entered July 25, 1973, the court ordered Bestline to dismantle its pyramid scheme, required Bestline and

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[29]Specifically, the California attorney general charged the defendants with having violated Cal.Bus. & Prof.Code §17500 (West 1979) which provided in pertinent part:

> False or misleading statements. It is unlawful for any person, firm, corporation or association, or any employee thereof with intent directly or indirectly to dispose of real or personal property or to perform services, professional or otherwise, or anything of any nature whatsoever or to induce the public to enter into any obligation relating thereto, to make or disseminate or cause to be made or disseminated before the public in this State, in any newspaper or other publication, or any advertising device, or by public outcry or proclamation, or in any other manner or means whatever, any statement, concerning such real or personal property or services, professional or otherwise, or concerning any circumstance or matter of fact connected with the proposed performance or disposition thereof, which is untrue or misleading, and which is known, or which by the exercise of reasonable care should be known, to be untrue or misleading, or for any such person, firm, or corporation to so make or disseminate or cause to be so made or disseminated any such statement as part of a plan or scheme with the intent not to sell such personal property or services, professional or otherwise, so advertised at the price stated therein, or as so advertised.

The attorney general introduced as evidence of this charge the consent decree entered into between the defendants and the State of California. He also charged the defendants with having

Bailey to make restitution to several thousand California direct distributors (Bestline being primarily liable; Bailey being secondarily liable), and imposed civil penalties of $1,000,000 against Bestline, $250,000 against Bailey, and a total of $200,000 against the other individual defendants. To effectuate such restitution, the court provided for the appointment of a receiver who would process the claims of distributors and determine the amounts due them.

(Footnote 29 Continued)
violated Civil Code §3369(2) (West 1979) and Cal.Penal Code §327 (West 1979) which provided as follows:

Cal.Civil Code §3369(2):

> Any person performing or proposing to perform an act of unfair competition within this State may be enjoined in any court of competent jurisdiction.

Cal.Civil Code §3369(3) (West 1979) defined "unfair competition" as follows:

> As used in this section, unfair competition shall mean and include unlawful, unfair or fraudulent business practice and unfair, untrue or misleading advertising and any act denounced by Business and Professions Code Sections 17500 to 17535, inclusive.

Cal.Penal Code §327 (West 1979) provided:

> §327 Endless chain scheme
>
> Every person who contrives, prepares, sets up, proposes, or operates any endless chain is guilty of a misdemeanor. As used in this section, an "endless chain" means any scheme for the disposal or distribution of property whereby a participant pays a valuable consideration for the chance to receive compensation for introducing one or more additional persons into participation in the scheme or for the chance to receive compensation when a person introduced by the participant introduces a new participant. Compensation, as used in this section, does not mean or include payment based upon sales made to persons who are not participants in the scheme and who are not purchasing in order to participate in the scheme.

By the time the superior court entered its judgment, Bestline had instituted Chapter 11 reorganization proceedings[30] in the bankruptcy court of the Northern District of California. The bankruptcy court immediately stayed the enforcement of that judgment and any further proceedings against Bestline.

With this stay order in place, Bestline and its codefendants moved the superior court to vacate its judgment on the ground that Bestline's pyramid structure and marketing practices were not in violation of California state law. In the alternative Bestline moved the court to modify the remedial provisions of its judgment providing for restitution and penalties. While these motions were pending, the Bestline defendants entered into negotiations with the California attorney general as to some modifications the court might incorporate into its final judgment. They eventually came to an agreement and jointly proposed several modifications to the superior court. The court accepted the parties' suggestions and on December 21, 1973, after the Chapter 11 bankruptcy court's stay order had been dissolved, denied the defendants' motion to vacate the judgment and entered a modified judgment (the California Judgment), incorporating the agreed-upon changes.

This modified judgment provided that the defendants would make restitution to all of Bestline's direct distributors in California (which the parties anticipated would amount to approximately $12 million) and to direct distributors elsewhere who obtained judgments through private lawsuits or were the beneficiaries of judgments obtained against Bestline by state attorneys

[30]Bestline sought reorganization under the Bankruptcy Act of 1898.

general proceeding *parens patriae*.[31] Although the California attorney general was under no obligation to provide a remedy to non-Californian distributors, the restitutionary provisions were expanded to include outside distributors in the hope that they would seek satisfaction under the provisions of the modified judgment and forego execution on their judgments, thus avoiding, perhaps, the depletion of Bestline's assets and possible bankruptcy proceedings.

The superior court, in its modified judgment, appointed Sylva[32] "Compliance Officer," to act as an ombudsman or special master charged with the duty of approving direct distributor claims and monitoring the Bestline defendants' compliance with the court's judgment. The court also created in the Bank of America an irrevocable trust fund, the California Fund, to which Bestline would forward its restitution payments and from which the distributors would be paid, at Sylva's direction. The court required Bestline to make an initial payment of $3,980,000[33] and thereafter semiannual

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[31]The judgment also provided that a direct distributor who received an arbitration award pursuant to a national plan of arbitration or whose claim Bestline approved was also entitled to participate. The first group, arbitration award recipients, never materialized because a national plan of arbitration was never adopted. As for the second group, the record does not indicate how many distributors became eligible to participate because Bestline approved their claims. The number, if any, however, would not affect the issues before us here.

[32]*See supra* note 4.

[33]It appears that Bestline actually transferred $4,085,936.61 to the California Fund. We are unable to ascertain the cause of this discrepancy.

payments until all eligible distributors received full restitution. The first semiannual payment, $250,000, was to be made on January 1, 1976.[34] If Bestline failed to make two consecutive semiannual payments, the California attorney general could petition the superior court to terminate the California Fund and appoint a receiver to liquidate Bestline's California assets. The eligible distributors were to begin receiving restitution on January 1, 1975, after Bestline made its initial payment, and thereafter semiannually until full restitution was made.[35]

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[34]The remaining payments by Bestline to the California Fund were scheduled as Follows:

June 30, 1976	500,000, or 50% of pre-tax profits whichever is greater.
January 1, 1977	500,000
June 30, 1977	750,000, or 50% of pre-tax profits whichever is greater.
January 1, 1978	750,000
June 30, 1978 ..... and on or before each June 30 of each successive year.	1,000,000, or 50% of pre-tax profits whichever is greater.
January 1, 1979 ..... and on or before each January of each successive year.	1,000,000

[35]The remaining payments from the California Fund were scheduled as follows:

January 1, 1975	1,000,000
June 30, 1975	1,000,000
January 1, 1976	250,000
June 30, 1976	500,000, or 50% of pre-tax profits whichever is greater.

On January 4, 1974, Bailey, who remained secondarily liable under the modified judgment for Bestline's restitutionary obligations and who was liable for $250,000 in civil penalties, entered into a settlement with the State of California under which the State agreed to accept from Bailey $750,000 in full accord and satisfaction of his contingent liability for restitution and $250,000 for his liability for the civil penalties. Under this settlement, Bailey made no admission of liability[36] and retained the right to question the superior court's adjudication of liability on appeal.

The defendants thereafter appealed, challenging the superior court's determination that Bestline's practices were in violation of state law; they did not attack the remedial provisions of the court's modified judgment. The court of appeals affirmed the superior court's

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(Footnote 35 Continued)

January 1, 1977	500,000
June 30, 1977	750,000, or 50% of pre-tax profits whichever is greater.
January 1, 1978	750,000
June 30, 1978 ..... and on or before each June 30 of each successive year.	1,000,000, or 50% of pre-tax profits whichever is greater.
January 1, 1979 ..... and on or before each January of each successive year.	1,000,000

[36] *United Airlines, Inc. v. McDonald*, 432 U.S. 385, 400, 97 S.Ct. 2464, 2473, 53 L.Ed.2d 423 (1977) (ordinary settlement of the issue of liability renders the case or controversy moot).

determination on all issues. *People v. Bestline Products, Inc.*, 61 Cal. App.3d 879, 132 Cal.Rptr. 767 (1976).

Following the implementation of the California Judgment, the attorneys general of Missouri, Ohio, Pennsylvania, New Jersey, Texas, and Wisconsin and the New York City Bureau of Consumer Protection brought similar *parens patriae* suits on behalf of Bestline direct distributors and obtained money judgments. All the beneficiaries of these judgments elected to seek restitution through the California Fund.

2.

On July 20, 1973, five days before the Los Angeles County Superior Court entered its original judgment against Bestline and Bailey, attorney Carl H. Hoffman filed this class action in the U.S. District Court for the Southern District of Florida against Bestline, Bailey, and another Bestline officer,[37] alleging that the sale of Bestline's distributorships violated both the Securities Act of 1933 (the Securities Act of 1933), 15 U.S.C. §77a et seq. (1982), and the Securities Exchange Act of 1934 (the Exchange Act of 1934), 15 U.S.C. §78a et seq. (1982), and seeking money damages. The district court, on being advised that the bankruptcy court for the Northern District of California had stayed all judicial proceedings against Bestline, dismissed the complaint without prejudice. On September 27, 1973, after the stay order was lifted, the district court vacated its dismissal order and reinstated this suit. The Judicial Panel on Multi-District Litigation subsequently consolidated, for discovery purposes, this case with

[37]This person was David L. Eastis, then president of Bestline.

several other private lawsuits pending against Bestline,[38] and on October 3, 1974, the district court designated Carl H. Hoffman and James H. Joseph (who previously had made and appearance for the plaintiffs in the instant case, as Hoffman's co-counsel) lead counsel for the plaintiffs in the consolidated cases.

On November 12, 1974, Lead Counsel amended the complaint in the instant case to add two pendent state law claims: first, that Bestline's direct distributorships were unconscionable contracts in violation of section 2-302 of the Uniform Commercial Code; second, that the manner in which Bestline's direct distributorships were sold amounted to common law fraud and deceit.[39] The amended complaint also added as parties defendant numerous other officers, directors, or shareholders of Bestline.

On November 22, 1974, the district court ordered this case to proceed as a class action, but only as to the plaintiffs' claims under the federal securities laws. It certified as a class those persons, numbering about 40,000, who had invested in direct distributorships and

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[38]"[T]he Judicial Panel on Multidistrict Litigation transferred six cases to the Southern District of Florida for consolidation with the [instant] case. . . . *In re Bestline Products Securities and Antitrust Litigation*, 375 F.Supp. 926 (Jud.Pan.Multi.Lit. 1974). Later, it transferred four Texas cases to the Florida court, 405 F.Supp. 313 (Jud.Pan.Multi.Lit. 1975), as well as one North Carolina case. Most of these cases were class actions and alleged violations of the federal securities laws and various state laws.

Piambino I, 610 F.2d at 1308 n. 3.

[39]In their amendment to their complaint, Lead Counsel did not indicate which state law governed their pendent claims under the Uniform Commercial Code and the tort law of fraud and deceit.

had never become general distributors.[40] Many who were receiving restitution from the California Fund were, by definition, members of the plaintiff-class;[41] they comprise, for our purposes, the Minority Group. Conversely, all the members of the plaintiff-class who were not then participants in the California Fund, i.e., the Majority Group, would become eligible to receive payments from the Fund if they recovered a money judgment in this case.

Prior to the time the district court certified the plaintiff-class, Lead Counsel knew that the Minority Group, whom they were representing, were receiving restitution payments from Bestline through the California Fund. Lead Counsel also knew that, if Bestline made full restitution under the California Judgment, it would have few, if any, resources to satisfy a judgment, and pay an attorney's fee, in this case. In short, Lead Counsel knew that, if they were to obtain a recovery, they would have to stop the flow of money from Bestline to the California Fund; they would have to litigate against

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[40]In addition, direct distributors who had reordered products from Bestline after May 22, 1977 were excluded from the class on the assumption that such persons would have an interest in Bestline's survival and thereby be in conflict with inactive distributors. General distributors were excluded from the class for the same reason.

[41]Although it does not appear that *all* of the members of the California Fund were also eligible for membership in the plaintiff-class, for the provisions of the California Judgment also provided for the inclusion of non-direct distributors, the parties and the *Piambino I* panel appear to have presumed this to be the case. Whether this presumption is true would not alter our decision here, and we will henceforth treat the California Fund as if it included only direct distributors.

their own clients, the Minority Group. Lead Counsel chose to do so indirectly, through Sylva.

Lead Counsel's litigation against Sylva, and thus against the Minority Group, has taken place in five forums—the Los Angeles County Superior Court, the U.S. District Court for the Northern District of California, the Ninth Circuit, the court below, and this court—and it has spanned nine years. This litigation began on September 20, 1974, when Lead Counsel, purportedly acting on behalf of the plaintiff-class, wrote a letter to the Bank of America, which held the California Fund, demanding that the bank cease drawing restitution checks on the Fund payable to the claimants Sylva had been designating. These claimants of course included the members of the Minority Group. Counsel advised the bank that their clients who had not been receiving restitution payments, i.e., the Majority Group, had a "prior equity" in the monies on deposit in the California Fund, because these monies were "directly traceable to money paid into Bestline by [the plaintiff-class] pursuant to a pyramid franchising scheme," and that the California Fund was subject to a constructive trust in their favor. Thus, the bank would be liable to Lead Counsel's clients in the Majority Group for their proportionate share of the monies in the California Fund. Lead Counsel sent a follow-up letter on October 8, 1974, warning the bank that, if it continued issuing restitution checks, they would sue the bank for an injunction and for their clients' share of the restitution payments previously made.

Disturbed by Lead Counsel's letters, the Bank of America petitioned the Los Angeles County Superior Court for instructions as to its duties under the California Judgment. The court held a hearing on the petition.

Lead Counsel appeared and argued that the Bestline distributors comprising the Majority Group were entitled to *all* of the monies in the California Fund, despite the fact that those distributors had not recovered a judgment against Bestline and thus were not entitled to participate in the restitution program established by the superior court's judgment. They requested the court to enjoin Sylva and the bank from making any further distributions from the California Fund and to impose a constructive trust on the Fund, solely for the benefit of their clients in the Majority Group. The superior court summarily rejected Lead Counsel's request and instructed the bank to continue disbursing the monies as required by the California Judgment.

Having failed in the Los Angeles County Superior Court, Lead Counsel turned to the federal court in San Francisco for relief. On November 15, 1974, the day after the superior court's ruling, Lead Counsel, acting in behalf of the entire plaintiff-class, filed suit in the U.S. District Court for the Northern District of California against Sylva, the Bank of America, the Los Angeles County Superior Court, the California attorney general, and Bestline. Lead Counsel sought essentially the same relief they had sought in state court, an injunction prohibiting Sylva and the Bank of America from making any further distributions from the California Fund and the imposition of a constructive trust for the benefit of the Majority Group. They alleged that the defendants were violating 42 U.S.C. §1983 (1982)[42] by enforcing, in

[42]42 U.S.C. §1983 provides in pertinent part:

> Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory or the District of Columbia, subjects, or causes to be subjected, any

behalf of the State of California, a judgment that denied the Majority Group the equal protection of the laws and due process of law under the ninth and fourteenth amendments.

In an amendment to their complaint, Lead Counsel presented two additional claims for relief. First, they alleged that Bestline's practices in selling its direct distributorships to the plaintiff-class violated the Securities Act of 1933 and the Exchange Act of 1934 and that the Bank of America had aided and abetted Bestline in these violations. Second, they alleged that the means by which Bestline marketed its distributorships amounted to common law fraud and deceit and that the Bank of America had participated in such fraud and deceit. These federal securities laws and fraud and deceit claims were "virtually identical"[43] to the claims Lead Counsel were, and are, prosecuting in the instant case. Lead Counsel also sought the same sort of relief they were seeking in this case: restitution, any consequential damages the plaintiff-class may have incurred, and punitive damages.

The defendants, severally, moved to dismiss the complaint, as amended, for failure to state a claim for

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(Footnote 42 Continued)

> citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress. . . .

[43]Lead Counsel made the statement in their amendment to their complaint that the federal securities laws and fraud and deceit claims they alleged were "virtually identical" to those in this case.

relief. *See* Fed.R. Civ.P. 12(b). On March 28, 1975, the district court convened a hearing on the defendants' motions to dismiss. Lead Counsel failed to attend the hearing. On April 4, 1975, the district court, noting that the plaintiffs had filed nothing in opposition to the defendants' motions, granted these motions and dismissed plaintiffs' amended complaint with prejudice. Lead Counsel appealed this dismissal to the Ninth Circuit Court of Appeals but abandoned their appeal before the court could take it under submission. The Ninth Circuit accordingly dismissed the appeal, without opinion, on February 24, 1976.

[7] On May 19, 1975, while their appeal to the Ninth Circuit was pending, Lead Counsel moved the district court below to declare, on partial summary judgment, that, for purposes of their claims under the federal securities laws, Bestline's direct distributorships were "securities." Neither Lead Counsel nor the attorneys for Bestline advised the court that only a month earlier the U.S. District Court for the Northern District of California had dismissed with prejudice a class-action suit Lead Counsel had brought in behalf of the plaintiff-class against Bestline (and others) containing the same federal securities laws claims.[44] On March 19, 1976, a

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"A lawyer is subject to discipline for failing to apprise a court of controlling authority that is directly adverse to his position and which is not disclosed by opposing counsel. ABA Model Code of Professional Responsibility DR 7-106(B)(1); ABA Model Rules of Professional Conduct Rule 3.3(a)(3); Florida Code of Professional Responsibility DR 7-106(B)(1) (1984). Lead Counsel's failure to apprise the district court of the dismissal, on the merits, of these "virtually identical" claims in the Northern District of California, *see supra* text at 1130-1131, or the Ninth Circuit's later dismissal of their appeal from that disposition, *see supra* text at 1131, would appear to subject Lead Counsel to disciplinary proceedings under the above-cited authority.

few days after the Ninth Circuit dismissed Lead Counsel's appeal from the dismissal of the California class action, the district court granted Lead Counsel's motion,[45] declaring that the direct distributorships the plaintiffs had purchased from Bestline constituted securities.

[8, 9] At this point, Lead Counsel attempted, once again, to freeze Bestline's assets in the hope that there would be funds available to satisfy their clients' claims, to pay an attorney's fee and to reimburse them for the litigation expenses they had advanced, which were mounting. On March 23, 1976, they moved the court below to place in receivership Bestline and its two founding principals, Bailey and Brassfield. Their chances of prevailing on such a motion were, they no doubt knew, very slim, since precedent of long standing was squarely against them. This precedent holds that the receivership remedy they sought is available only to plaintiffs with an equitable interest in the property to be seized or with judgments that cannot otherwise be satisfied.[46] Such a receivership is not available to plaintiffs, such as those Lead Counsel were representing, who

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[45]The court was apparently unaware of the Ninth Circuit's ruling.

[46]For a general discussion on the propriety of the appointment of a receiver, *see* 12 C. Wright & A. Miller, *Federal Practice and Procedure*, §§2981-86 (1973). As a general rule, receivers may only be appointed when the party seeking receivership has some "legally recognized right in [the] property [he wishes to seize] that amounts to more than a mere claim against defendant." *Id.*, §2983, at 17. A judgment creditor may only proceed in equity for the appointment of a receiver after he has exhausted his legal remedies, i.e., he has attempted to execute on his judgment but it remains unsatisfied. *Pusey & Jones Co. v. Hanssen*, 261 U.S. 491, 497, 43 S.Ct. 454, 455-56, 67 L.Ed. 763 (1923).

are merely prosecuting a tort action for the recovery of unliquidated money damages and have not reduced their claims to judgment. Bestline, Bailey, and Brassfield strenuously objected to the appointment of a receiver, citing this precedent, and the California attorney general, appearing *amicus curiae*, joined in their objection. The attorney general also advised the court that Lead Counsel had previously been unsuccessful in their attempts to obtain essentially the same relief in state and federal courts in California. He stressed the point that, if the court appointed a receiver, the California Fund would collapse and thousands of California and non-California distributors, who had foregone the chance to execute on their judgments, would be denied the restitution to which they had become entitled by the force of judgments the district court should accord full faith and credit. The district court declined to place the three defendants in receivership,[47] thus leaving Lead Counsel still empty handed.

Lead Counsel did not tarry long in launching a new plan to solve their financial problems; on April 1, 1976, they joined the Bank of America as a party defendant to the class action. They alleged, as they had in the Northern District of California, that the Bank had aided and abetted Bestline's violation of the federal securities laws. Lead Counsel's plan had little chance of success for two quite obvious reasons. First, the Southern District of Florida was an inappropriate venue for the plaintiffs'

[47]The court also declined to act on Lead Counsel's "Ancillary Complaint for Creditor's Bill," the pendent state law counterpart to their petition for receivership.

claims against it.[48] Second, should the district court conclude that its venue was proper, the bank, in its answer, would plead res judicata, contending that the judgment it had obtained against the plaintiffs in the Northern District of California, in a suit involving the identical claims Lead Counsel were presenting against it in the instant case, operated as a bar. The bank promptly moved the district court to dismiss it as a party defendant for want of proper venue, and, following the Supreme Court's then recent holding in *Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 96 S.Ct. 1989, 48 L.Ed.2d 540 (1976), the district court granted the bank's motion.

Shortly after Lead Counsel brought the Bank of America into this litigation, and while the bank's motion for dismissal was pending, they discovered another possible source of revenue, a suit the United States was prosecuting against William E. Bailey, under 15 U.S.C. § 45(*l*) (1982),[49] in the U.S. District Court for the

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[48]12 U.S.C. §94 (1976) provided that

> [a]ctions and proceedings against [a national bank] under this chapter may be had in any district or Territorial court of the United States held within the district in which such [bank] may be established, or in any State, county, or municipal court in the county or city in which said [bank] is located having jurisdiction in similar cases.

The Bank of America was not present in the Southern District of Florida within the meaning of this statute.

[49]15 U.S.C. §45(*l*) provides:

> **(1) Penalty for violation of order; injunctions and other appropriate equitable relief**
>
> Any person, partnership, or corporation who violates an order of the [FTC] after it has become final, and while such

Northern District of California. On April 2, 1976, that court had found Bailey liable to the United States for violating the terms of the cease and desist order[50] Bailey and Bestline had consented to with the FTC in 1971, *see supra* text at 1125, and scheduled an evidentiary hearing on May 28, 1976 to determine the amount of the civil penalties Bailey would have to pay the government for those violations. *United States v. Bestline Products Corporation*, 412 F.Supp. 754 (N.D.Cal. 1976). Bailey's exposure was substantial, at $10,000 for each violation,[51] and Bailey anticipated that a substantial judgment would be entered against him. He was also concerned about his exposure in the instant case.

(Footnote 49 Continued)

> order is in effect, shall forfeit and pay to the United States a civil penalty of not more than $10,000 for each violation, which shall accrue to the United States and may be recovered in a civil action brought by the Attorney General of the United States. Each separate violation of such an order shall be a separate offense, except that in a case of a violation through continuing failure to obey or neglect to obey a final order of the [FTC], each day of continuance of such failure or neglect shall be deemed a separate offense. In such actions, the United States district courts are empowered to grant mandatory injunctions and such other and further equitable relief as they deem appropriate in the enforcement of such final orders of the [FTC].

[50]15 U.S.C. §45(*l*) provides that, if any person violates a cease and desist order of the FTC, he may be assessed penalties in a civil action brought by the Attorney General.

[51]15 U.S.C. §45(*l*) provides in pertinent part that

> [a] civil penalty of not more than $10,000 for each violation . . . shall accrue to the United States . . . [with each day of a] continuing failure to obey or neglect to obey a final order of the [FTC] . . . deemed a separate offense. . . .

At this point, Bailey conceived a plan to cut his losses; he would buy his way out of two lawsuits for the price of one. He knew the plan would appeal to Lead Counsel because, if it succeeded, it would give them funds to defray their litigation expenses and perhaps provide them with an attorney's fee. It did not take long for Bailey and Lead Counsel to strike a bargain. They agreed that the plaintiff-class would settle their claims against Bailey for $750,000, less the amount of the penalties the U.S. District Court for the Northern District of California assessed in favor of the United States; provided that, if these penalties exceeded $750,000, the settlement would be null and void. Under this arrangement, if the district court in California assessed Bailey's penalties at $750,000, that sum would be deducted from the $750,000 settlement here and the plaintiff-class would receive nothing. If, however, the penalties amounted, for example, to $600,000, the plaintiff-class would receive $150,000, less Lead Counsel's expenses (set by them at $50,000) and a reasonable attorney's fee. Bailey and Lead Counsel also agreed that any member of the plaintiff-class who had participated in the California Fund, i.e., the Minority Group, would receive *none* of the settlement proceeds. They reasoned that the Minority Group had already obtained an adequate recovery from Bailey out of the $750,000 settlement he had made with the California attorney general on January 4, 1974. *See supra* text at 1128.

Lead Counsel and Bailey immediately presented their settlement to the court below for preliminary approval, and the court approved it on June 8, 1976. Eight days later, however, the settlement, by its own terms, became null and void when the district court in

California ordered Bailey to pay the United States $1,036,000 in civil penalties.[52]

With this adverse turn of events, Lead Counsel renewed their efforts to tie up Bestline's assets and to obtain some quick cash, once again at the expense of the Minority Group. As we have related in Part I.A., *supra*, in mid-June 1976, Bestline was preparing to make a $500,000 payment to the California Fund; the payment was due on June 30. On June 18, Lead Counsel moved the district court for a temporary restraining order pursuant to Fed.R.Civ.P. 65(b),[53] contending, as they had in the California state and federal courts, that the California Fund, in disbursing Bestline's restitution payments to the Minority Group, was discriminating against the Majority Group in violation of their fourteenth amendment equal protection and due process rights.[54] On June 30, the court convened a hearing on the motion. Bestline and the California attorney general appeared and strenuously opposed the motion. The attorney general

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[52]This order is unpublished.

[53]Fed.R.Civ.P. 65(b) provides in pertinent part:

> (b) **Temporary Restraining Order; Notice; Hearing; Duration.** A temporary restraining order may be granted without written or oral notice to the adverse party or his attorney only if (1) it clearly appears from specific facts shown by affidavit or by the verified complaint that immediate and irreparable injury, loss, or damage will result to the applicant before the adverse party or his attorney can be heard in opposition, and (2) the applicant's attorney certifies to the court in writing the efforts, if any, which have been made to give the notice and the reasons supporting his claim that notice should not be required.

[54]Lead Counsel's conduct in urging the district court to grant the temporary restraining order on these fourteenth amendment grounds was, arguably, unethical. *See supra* note 44. The U.S.

argued that the plaintiffs' fourteenth amendment claims had already been decided adversely to the plaintiffs in the U.S. District Court for the Northern District of California and were therefore barred.

The district court ruled from the bench. Rejecting the attorney general's res judicata/collateral estoppel argument, it considered Lead Counsel's motion for a temporary restraining order as an application for a preliminary injunction in aid of the court's jurisdiction and granted it. The court directed Bestline to deposit the June 30 payment to the California Fund in the registry of the court and enjoined it from making any further payments to the Fund. It announced that, unless it took such action, Bestline would have no resources with which to satisfy any judgment the plaintiffs might eventually receive in this case.[55]

After the court announced its ruling, Bestline complained that the court had failed to require the plaintiffs to post a bond, as mandated by Fed.R.Civ.P. 65(c). The court acknowledged this failure and stated that the $500,000 Bestline would be depositing into the registry of the court would serve as such a bond. On July 7, the court memorialized its preliminary injunction

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(Footnote 54 Continued)

District Court for the Northern District of California had expressly rejected these precise grounds, and the Ninth Circuit had dismissed Lead Counsel's appeal from that disposition, in a similar factual context. *See supra* text at 1130-1131.

[55]The district court's injunction was the equivalent of an attachment before judgment in a statutory tort suit for unliquidated money damages. No authority has been cited in support of such a remedy in a case such as this.

with a written order. On August 6 Bestline appealed that order to this court.[56]

Meanwhile, Lead Counsel and Bailey resumed settlement negotiations. The U.S. District Court for the Northern District of California had amended its judgment against Bailey to provide that Bailey could deduct from the $1,036,000 in civil penalties he owed the United States any amount that he might pay to the plaintiff-class in this case.[57] This amendment gave Bailey strong incentive to settle with the plaintiff-class, and they promptly reached an agreement. Bailey would pay the plaintiff-class $1,036,000 for a release of all of their claims against him. As the first settlement agreement Bailey negotiated with Lead Counsel provided, this amount would be distributed only to the members of the Majority Group; those in the Minority Group would not participate. The agreement also provided that Lead Counsel would receive a $250,000 attorney's fee, and litigation expenses, for the settlement proceeds.

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[56]In its notice of appeal, Bestline also sought review of the district court's summary judgment determination that its distributorships constituted securities. This partial summary judgment was interlocutory in nature and thus not appealable, *see* 10 C. Wright, A. Miller & M. Kane, Federal Practice and Procedure §2715 (2d ed. 1983), unless the district court certified that the disposition involved "a controlling question of law as to which there is a substantial ground for difference of opinion and that an immediate appeal from the [summary judgment] order may materially enhance the ultimate termination of the litigation." *See* 28 U.S.C. §1292(b) (1982). The district court denied Bestline's application for a certificate on June 30, 1976, when it issued the preliminary injunction. Although we are uncertain how the *Piambino I* panel reviewed the summary judgment without a §1292(b) certification, this issue is not now before this court.

[57]This order is unpublished.

The district court preliminarily approved this second Bailey settlement on October 10, 1976. On December 17, 1976, the plaintiff-class, including the Minority Group, received notice of the proposed settlement. The notice included proof of claim forms. Anyone who wished to participate in the settlement was required to complete and return a form. The notice stated that the members of the Minority Group were not eligible to participate in the settlement; consequently, most of the members of that Group, approximately five-sevenths, did not return proof of claim forms.

After the period for submitting claim forms expired, the district court convened a hearing to pass on Lead Counsel's application for final approval of the settlement. The Department of Justice had, apparently, decided to acquiese in Bailey's use of $1,036,000 in government funds (the $1,036,000 he owed the United States in civil penalties) to obtain a release of the plaintiffs claims against him,[58] but it objected to the use of any of government funds to pay Lead Counsel an attorney's fee. An attorney from the Department therefore appeared to protest the fee award Lead Counsel and Bailey's lawyers had negotiated. He argued that Lead Counsel were not entitled to a fee because they had done nothing to generate the settlement proceeds; rather, those proceeds had been created solely through the efforts of government counsel in prosecuting the suit for civil

[58]The record does not contain an explicit indication that the Department of Justice decided to acquiesce in Bailey's use of these government funds to settle the instant case. We draw the assumption that it decided to acquiesce from its argument in the court below that Lead Counsel should not be awarded an attorney's fee from those funds.

penalties against Bailey in the Northern District of California. The district court, questioning whether the Department of Justice had a right to appear and protest, found that Lead Counsel had made a "substantial contribution"[59] to the acquisition of the settlement funds and approved the $250,000 attorney's fee and the other terms of the settlement. On February 15, 1977, it entered a final judgment incorporating the settlement and disposing of the plaintiffs' case against Bailey. At the same time, the court instructed Bailey to apply to the U.S. District Court for the Northern District of California for an order transferring the $1,036,000 Bailey had previously deposited in that court's registry to the registry of the U.S. District Court for the Southern District of Florida. Bailey followed this instruction and the funds were transferred.

With the Bailey settlement in hand, Lead Counsel negotiated a settlement with Bestline and the remaining twenty-seven individual defendants. Once again, the negotiators preferred the Majority Group at the expense of the Minority Group. Unlike the Bailey settlement, however, the Bestline settlement did not, by its terms, totally shut out the Minority Group.

The Bestline settlement provided that (1) the defendants, collectively, would pay the plaintiff-class $900,000 in cash, (2) Bestline would give the plaintiffs a promissory note for $300,000, guaranteed by Jerry Brassfield, (3) Bestline would liquidate all of its assets and pay the proceeds to the plaintiff-class, (4) Bestline would dismiss its appeal from the district court's June 30, 1970 preliminary injunction and relinquish whatever

[59]The district court did not explain precisely what Lead Counsel's "substantial contribution" was.

claim it had to the $500,000 it had deposited in the court's registry on that date to serve, as the court had ordered, as a Fed.R. Civ.P. 65(c) bond, and (5) Lead Counsel would receive out of the settlement proceeds a $750,000 attorney's fee and up to $50,000 in litigation expenses.

The means Lead Counsel used to prefer the participation of the Majority Group over the Minority Group in the settlement was the notice of settlement they sent to the members of the plaintiff-class. The notice went only to those who had returned proof of claim forms in connection with the Bailey settlement. As we have noted, only two-sevenths of the Minority Group returned proof of claim forms. The Group had been advised, in the notice of the Bailey settlement, that they were to receive nothing from Bailey, and consequently they had no incentive to submit a proof of claim. To do so would have been a useless act. Moreover, they could not have known that, by failing to submit a claim form with respect to the Bailey settlement, they would foreclose their right to participate in a subsequent Bestline settlement. Thus, because only two-sevenths of the Minority Group received notice of the Bestline settlement, only two-sevenths returned proof of claim forms[60] and, thus, only two-sevenths became eligible to share in the proceeds thereof.

By the time the notice of the Bestline settlement had been circulated, it had become apparent to Sylva, as the Compliance Officer under the California Judgment, that the interests of the Minority Group had been

[60]Actually, some of the two-sevenths who received notice of the Bestline settlement neglected to return proof of claim forms. Less than two-sevenths therefore became eligible to share in the proceeds thereof.

completely forsaken. Lead Counsel, ostensibly representing that Group, had succeeded in cutting most of them out of the case. In addition, Bestline, which had been telling Sylva that it was vigorously pursuing its appeal from the district court's June 30, 1976 preliminary injunction, had all but abandoned it.[61] On February 14, 1977, seventeen days after Lead Counsel filed the proposed Bestline settlement with the district court, Sylva moved the district court to intervene, as a party plaintiff representing the Minority Group.

As we have stated in Part I.A., *supra*, Sylva presented two reasons for intervening: first, to obtain the dissolution of the preliminary injunction so that Bestline could resume its restitution payments to the California Fund; second, to protect the interests of the Minority Group in the instant case. He asked the court to create a plaintiff-subclass, comprised of the plaintiffs in the Minority Group, and to designate him as the representative of that subclass.

The district court took Sylva's motion under advisement. On March 11, 1977, at the hearing it convened to consider Lead Counsel's application for the final approval of the Bestline settlement, the court recognized Sylva's appearance for the limited purpose of voicing any objections he might have to the settlement. Sylva protested that the settlement amount was too small and that the attorney's fee was too large. He also urged the court to send a new notice of settlement to the members of the Minority Group so that they would have an opportunity to participate.

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[61] *Piambino I* describes in considerable detail the manner in which Bestline lulled Sylva into believing that it was vigorously pursuing its appeal. 610 F.2d at 1325-26 & n. 23.

On March 22, 1977, the court entered an order denying Sylva's motion to intervene, approving the settlement, and awarding Lead Counsel the attorney's fee they had negotiated. The court did not explain why it denied Sylva intervention, except to say that his motion to intervene was both untimely and meritless. Turning to the settlement, the court concluded that it was the result of arms-length negotiations, that its terms were fair, reasonable, and adequate and that the notice of settlement (that had been sent only to the members of the plaintiff-class who had returned proof of claim forms with respect to the Bailey settlement) was "the best practicable under the circumstances." The court further found that the proposed attorney's fee was reasonable because "the award and amount of attorneys fees [came] before this court in the posture of an unopposed settlement." The court observed that the only one who had objected either to the terms of the settlement or the amount of the attorney's fee was Sylva, but he was not a party to the litigation.

On March 25, 1977, three days after the court approved the Bestline settlement, Lead Counsel withdrew from the court's registry the $1,000,000 in attorney's fees they had received for the two settlements. On April 1, 1977, Sylva moved the court to set aside the disbursement of those fees and to stay the execution of the final judgment[62] entered pursuant to the Bestline

[62]Actually, Sylva, not being a party to the proceedings, lacked standing to move the court to set aside the fee disbursement and to stay the execution of the final judgment. As a nonparty, what Sylva was actually seeking was an injunction, an in personam order directing Lead Counsel to restore their attorney's fee and reimbursed expenses to the registry of the court and, with respect to the settlement, directing the parties to take no steps toward its execution. In our view, the district court, having denied Sylva intervention, had to deny his application for such injunctive relief.

settlement. The same day, the court, without a hearing, summarily denied Sylva's motion, and Sylva appealed. Thereafter, the clerk of the court disbursed the settlement funds to the members of the plaintiff-class who submitted proof of claim forms; the disbursement was completed by the time *Piambino I* was argued to this court. On December 5, 1980, we decided *Piambino I*, the consolidated appeals from the district court's June 30, 1976 injunction and its March 22, 1977 order denying Sylva's motion to intervene.

We have outlined the *Piambino I* panel's holdings, *see supra* text at 1119, and the strategy Lead Counsel, and the defendants who joined in the Bestline settlement, employed in the district court to circumvent those holdings. *See supra* text at 1118. Lead Counsel now acknowledge, as they must, that the panel, in unambiguous language, struck down their Bestline settlement and attorney's fee award as manifestly unfair; they contend, however, that the panel did not take the next step and provide for the disposition of the settlement proceeds and their fee.

Lead Counsel and the settling defendants have spent the monies they have received and, we have been told, they cannot pay them back. The settling defendants do not want the money.[63] As they announced at the close of oral argument, all they desire is an end to this litigation. Lead Counsel therefore submit that, even if we should conclude that *Piambino I* calls for the return of the money to the district court's registry, we

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[63]These defendants apparently have concluded that the settlement they made with Lead Counsel is worth more to them than a return of the settlement proceeds they provided and a potential judgment of no liability.

should invoke the third exception to the law of the case doctrine, which permits a trial court to avoid a previous appellate decision if adherence to that decision would be clearly erroneous and manifestly unjust, and affirm the district court. As we indicate in Subpart 3 that follows, Lead Counsel's argument must be rejected on all points.

3.

[10] We have no difficulty in concluding that the *Piambino I* panel properly intended that the monies disbursed in connection with the Bestline settlement be restored to the registry of the district court. We are also confident that requiring such restoration will not work a manifest injustice in this case. We draw these conclusions for two reasons. First, the panel intended to assuage the prejudicial effects Lead Counsel's conflict of interest and the district court's erroneous rulings had on the Minority Group. This intent permeates its opinion. Second, the panel intended to vindicate the prophylatic measures of the class-action rule, Fed.R.Civ.P. 23, that should have prevented the Bestline settlement from taking place.

The panel observed at the outset that there would have been no settlement at all had Lead Counsel not persuaded the district court to enjoin Bestline from making further restitution payments to the California Fund. Such an injunction was plainly unlawful, barred by the Anti-Injunction Act, 28 U.S.C. §2283 (1982).[64]

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[64]28 U.S.C. §2283 provides:

> A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments.

See *Piambino I*, 610 F.2d at 1330-34.

Lead Counsel urged the panel to uphold it, but, as the panel observed, their arguments were frivolous. *Piambino I*, 610 F.2d at 1330-34. The panel saw the injunction for what it was, a device conceived by Lead Counsel to generate funds for litigation expenses and attorneys' fees.

This device, however, destroyed the right of 7,043 Bestline distributors to obtain restitution from the California Fund. 2,300 of these distributors were from California; they were the initial beneficiaries of the California Judgment. The rest were from other states; they had withheld executing on their judgments and had turned to the California Fund in an effort to keep Bestline out of the bankruptcy courts and to achieve full restitution. The claims of these 7,043 distributors, which averaged over $3,000 apiece, totalled more than $21 million. As the panel noted, "[a]pproximately $4.5 million had been distributed to these persons before the District Judge issued his preliminary injunction halting further payments from Bestline to the [California Fund]," *id.* at 1329, and, had his injunction not issued, an additional $4.5 million would have been distributed. *Id.* In fact, Bestline would have satisfied in full its obligations under the California Judgment.[65] *Id.* at 1330.

The panel thus concluded that Lead Counsel's class action had "generated no common fund from which to pay [a settlement and] attorneys' fees and expenses," *id.*, and that the district court, in assessing the merits of the settlement, "erred by not making the [Minority

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[65]The *Piambino I* panel concluded that "long before" the Bestline settlement Bestline would have either satisfied the California Judgment or the Minority Group would "have obtained Bestline's assets through liquidation." 610 F.2d at 1330.

G]roup whole out of the settlement proceeds, or at least according them an absolute priority to all such funds." *Id.* If any doubts existed as to who should have first call on those funds—Lead Counsel and the Majority Group or the Minority Group—the panel removed them when it summarized the result of its decision:

> Thus, the result which we reach, by assuming that the 7,043 California [F]und participants were properly included in the class as defined by the District Court, is the same as that which would have been reached if those persons had not been included in the class and if the preliminary injunction had not issued. By concluding that those persons are entitled to settlement proceeds up to $4,500,000 plus interest, they are placed in the same position they would have been in if Bestline had made all the scheduled payments to the [California Fund].

Id.

The panel knew, of course, that the district court, in implementing its decision, could not order Lead Counsel and their clients to pay the monies they had received to the California Fund, the remedy Sylva reads into the panel's decision. Such an order is not explicit in the panel's mandate and in our view cannot be implied. In vacating the settlement and attorney's fee award and dissolving the injunction, the panel restored the litigation to the legal posture it occupied prior to the entry of the injunction and, also, the settlement. Bestline therefore would be free to complete the restitution required by the California Judgment.

Bestline had been liquidated, however, and the proceeds of the liquidation had been disbursed pursuant to the settlement; this fact had been made known to the panel. Consequently, the only Bestline funds available

to Sylva, both as Compliance Officer of the California Judgment and as the representative of the Minority Group prosecuting the claims in this case, were those in the hands of Lead Counsel and the settling plaintiffs. Sylva had two methods of pursuing them. He could bring suit against Lead Counsel and these plaintiffs, individually, in whatever jurisdiction they might be located, or he could petition the district court to order them to return the monies they had received to the court's registry. Neither method, of course, could restore Sylva and the Minority Group to the identical position they had occupied prior to the entry of the jurisdiction, since Bestline had been liquidated.

[11] Of the two methods available to Sylva, the second would come the closest to restoring him and the Minority Group to their pre-injunction position. If the monies were restored to the registry of the district court, Sylva, as Compliance Officer, could levy upon them, at least those drived from Bestline as opposed to the individual defendants, to satisfy the California Judgment.[66] And, as the Minority Group's representative in this case, he could also use the funds as a basis for negotiating a new settlement, or, failing that, to satisfy any judgment the plaintiffs might obtain from Bestline

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[66]The *Piambino I* panel made it clear that the California Judgment was entitled to full faith and credit under Article IV of the U.S. Constitution and 28 U.S.C. §1738 (1982). 610 F.2d at 1329. Sylva is entitled, therefore, to bring an action in the Florida courts, or in federal district court in Florida assuming that diversity jurisdiction exists, to reduce the California Judgment to a local judgment, thereby allowing him to levy on these funds. *See First Nat. Bank of Searcy, Arkansas v. Collins*, 372 So.2d 111, 113 (Fla.App.Ct. 1979); *National Equipment Rental, Ltd. v. Coolidge B & T Co.*, 348 So.2d 1236, 1238 (Fla.App.Ct. 1977); *Milligan v. Wilson*, 107 So.2d 773, 774-75 (Fla.App.Ct. 1958).

and its promoters. The first method would, as a practical matter, be worthless, except perhaps in the case of Lead Counsel. To pursue the individual plaintiffs in their own forums for the relatively small amounts they received would be unduly expensive and probably not worth the effort. We are convinced that the panel could not have intended such a result. Rather, it contemplated the restoration of the funds to the court's registry.[67]

The panel no doubt would have expressed this view had Lead Counsel informed it in oral argument, or later in their petition for rehearing, that they intended to preserve their settlement and, notwithstanding the panel's decision, would resist any effort to make them, or their clients, return the proceeds thereof to the district court's registry. Moreover, the panel would have included among its explicit holdings the instruction that the district court forthwith order Lead Counsel and the plaintiffs who had participated in the settlement to deposit the funds they had received, with interest, in the court's registry. Finally, the panel would have instructed the district court to determine whether Lead Counsel's financial stake in the case was such that Lead Counsel could no longer represent the interests of the Majority Group. We make this determination, ourselves, in Subpart C below.

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[67]Such restoration of the settlement proceeds, attorney's fee and expenses is supported by precedent. Upon reversing a money judgment, an appellate court, drawing upon the equitable principle of restitution, may direct a party who has obtained satisfaction of the judgment to return the monies he has received to the party who paid them or, in the event a new trial is ordered, to deposit them in the trial court's registry pending the outcome of the new trial. *See Northwestern Fuel Co. v. Brock*, 139 U.S. 216, 219, 11 S.Ct. 523, 524, 35 L.Ed. 151 (1891); *Kirtley v. Abrams*, 299 F.2d 341, 347-48 (2d Cir. 1962).

[12] The *Piambino I* panel expressed great concern about the district judge's fidelity to Rule 23 in approving the settlement of this class action. Rule 23 class actions accomplish many salutary goals; at the same time, they can cause great mischief. In both instances, the legal profession, judges and lawyers alike, are responsible for the result. The lawyers who bring these cases have a heavy fiduciary responsibility to their clients—especially those who are absent and those in the minority whose interests are at odds with the named plaintiffs and their group—to the trial judge and to the people, who provide the forums and governmental resources for these suits. Invariably, the plaintiffs' lawyers must look to the defendants for their fees and litigation expenses; invariably, they settle. Because of the potential for a collusive settlement, a sellout of a highly meritorious claim, or a settlement that ignores the interests of minority class members, the district judge has a heavy duty to ensure that any settlement is "fair, reasonable, and adequate" and that the fee awarded plaintiffs' counsel is entirely appropriate.[68]

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[68]*Cotton v. Hinton*, 559 F.2d 1326, 1330 (5th Cir. 1977) ("A 'mere boiler-plate approval phrased in appropriate language but unsupported by evaluation of the facts or analysis of the law' will not suffice." (citing *Protective Committee v. Anderson*, 390 U.S. 414, 434, 88 S.Ct. 1157, 1168, 20 L.Ed.2d 1 (1968); *see also Holmes v. Continental Can Co.*, 706 F.2d 1144, 1147 (11th Cir. 1983) ("[C]areful scrutiny by the court is 'necessary to guard against settlements that may benefit the class representatives or their attorneys at the expense of the absent class members.' " (citing *United States v. City of Miami*, 614 F.2d 1322, 1331 (5th Cir. 1980)); *Pettway v. American Cast Iron Pipe Co.*, 576 F.2d 1157, 1169 (5th Cir. 1978) ("The [class action] settlement process is more susceptible than adversarial adjudications to certain types of abuse . . . requiring that the trial court evaluate [the fairness of] the class action settlement. . . .")

The Bestline settlement the district judge approved was, as the *Piambino I* panel emphatically found, manifestly unfair. Lead Counsel's and the settling Bestline defendants' attempts to discredit the panel's conclusion are feeble and warrant no comment. The district court should have rejected the settlement as unfair because it was accomplished at the expense of the minority members of the plaintiff-class, primarily to provide Lead Counsel an attorney's fee. The Bailey settlement had been negotiated for the same purpose, and the district court should have taken this into account in passing on the Bestline settlement. We say this, even though the validity of the Bailey settlement was not before the court, because what motivated Lead Counsel to come to terms with Bailey had a bearing on the fairness, reasonableness, and adequacy of the Bestline settlement.

It should have been as obvious to the district court as it was to our prior panel that without the Bailey settlement there would have been no Bestline settlement on the terms the district court approved. Lead Counsel would not have agreed to the Bestline settlement because it would not have provided enough ready cash to pay the $1 million or more in fees and expenses Lead Counsel needed. To be sure, the Bestline defendants, collectively, were willing to pay $900,000 in cash and to "waive" any claim they might have had to the $500,000 Rule 65(c) bond[69] the plaintiffs posted

[69]Bestline's claim to the Rule 65(c) bond was of dubious value. If the July 30, 1976 preliminary injunction were set aside on appeal, Sylva, as Compliance Officer under the California Judgment, would have a claim, as a wrongfully enjoined party, against the bond for the injury the participants in the California Fund incurred as a result of the injunction. *See infra* note 71. In addition, he could levy on the bond proceeds to satisfy the California Judgment. *See supra* note 66.

when the court enjoined Bestline's restitution payments to the California Fund, but Lead Counsel could not have expected the court to award them most of that money in the form of fees and expenses. Such an award would have been highly suspect and would have engendered strong opposition. The Bailey settlement "sweetened the pot" and made the Bestline settlement palatable. In short, the United States' funds Bailey used to buy off the plaintiffs' claims enabled Lead Counsel to relax their demands against the remaining defendants and to settle for less.

The district court approved Lead Counsel's proposed attorney's fee because "no one opposed it", Sylva's objection did not count because he was not a party. Such perfunctory approval, the *Piambino I* panel held, constituted a complete abdication by the court of "its responsibility to assess the reasonableness of attorneys' fees proposed under a settlement of a class action," 610 F.2d at 1328, and, standing alone, was sufficient to vitiate the settlement. *Id.* Of course, the settlement was also invalid because of its highly prejudicial treatment of the Minority Group.

The Rule 23 policies that dictate the conduct of the trial judge and plaintiffs' counsel in class actions simply cannot accommodate the decision Lead Counsel urge us to make, which would allow Lead Counsel and the settling plaintiffs to retain the proceeds of the Bestline settlement. Such a decision would inform the trial bar and the bench that a rubber stamped settlement and negotiated fee award found on appeal to be unfair, unreasonable, or inadequate will be set aside only in theory, not in truth; once the settlement proceeds and attorney's fee are disbursed, the court will not order their retrieval. It requires no further discussion to

conclude that the result Lead Counsel propose cannot be countenanced. What is needed, instead, if we expect the public to have confidence in the rule of law, is a result that will ensure that the scenario in this case is not repeated.

Lead Counsel argue that it will work a manifest injustice if we require them and their clients to return the monies they have received. We address Lead Counsel's case first, because the answer is so clear: no equities weigh in their favor.

Lead Counsel took a calculated risk when, three days after the district court entered the final judgment incorporating the Bestline settlement and in the face of a certain appeal by Sylva, they withdrew from the court's registry $1,000,000 in attorneys' fees (the fees Lead Counsel were to receive for the combined settlements). Sylva had done everything the law allowed to stop Lead Counsel's rush for these fees. He tried to intervene; he objected to the Bestline settlement and the negotiated atttorney's fees; after the district court denied him intervention and approved the settlement, he moved the court to set aside the fee disbursement and to stay the execution of the final judgment; and, finally, he appealed to this court. Except for his motion to intervene, Sylva requested all of this action within six days of entry of final judgment. His requests could hardly have been more timely.

Lead Counsel knew that Sylva's appeal was meritorious and that their settlement and fee award were in jeopardy. First, Lead Counsel knew that the June 30, 1976 injunction, without there would have been no settlement, was entirely baseless. The injunction was precluded by the Anti-Injunction Act. Lead Counsel,

ignoring the proscription of the Act, informed the court that they wanted the injunction because the California Judgment, in denying restitution to the Majority Group while providing it to the Minority Group, was denying the former group their fourteenth amendment rights to equal protection and due process. Lead Counsel knew this argument could not prevail because it had been explicitly rejected by the U.S. District Court for the Northern District of California on April 4, 1975, when it dismissed *with prejudice* a class-action suit Lead Counsel had brought on the precise claims they were prosecuting in this case. The California attorney general, in opposing the issuance of the injunction, pointed this out to the district court, and the court accordingly rejected Lead Counsel's argument. The district court nevertheless granted the injunction, for an invalid reason Lead Counsel did not urge—to aid the court in the exercise of its jurisdiction. Lead Counsel could not have been surprised when the *Piambino I* panel rejected it.

Lead Counsel also should have anticipated the panel's ruling on the district court's denial of Sylva's motion to intervene. Sylva, as the Minority Group's *de facto*, if not *de jure*, representative, obviously had a stake in the outcome of the litigation. Lead Counsel's constant pursuit of Sylva in the state and federal courts of California, in the court below and in this court stood as a tacit admission of this fact. Counsel knew that, if the panel concluded that Sylva had a right to intervene, their settlement would fall. The settlement would fall because Sylva had demonstrated that it was the product of a lawyer-client conflict of interest of prohibitive magnitude.

As stated, Lead Counsel have no equities going for them on the question of whether they should turn over the money they have received. Accordingly, the district court, on receipt of our mandate, shall forthwith order Lead Counsel to pay into the registry of the district court all the monies they have received in consequence of the Bestline settlement, whether in the form of an attorney's fee or expenses, with interest from the date *Piambino I*'s mandate issued. The court shall enforce such order under its civil contempt power.

The case against the Majority Group and the members of the Minority Group who participated in the settlement presents a different question. They of course have no right to the monies they have received; the Bestline settlements is a nullity and they have no independent claim to its proceeds. But they have done nothing "wrong." They played no active role in the events that led to the settlement and could not have known of the risk they took in receiving and disposing of the Bestline settlement proceeds while the Sylva and Bestline appeals were pending in this court. One might argue that these plaintiffs should be faulted for choosing Lead Counsel as their lawyers, but we doubt that many of them participated in that decision. Nevertheless, these participating plaintiffs must restore the monies they have received to the court's registry. We reach this holding for two principal reasons.

First, Rule 23 requires such action; it will give the district judges and the plaintiffs' bar an added incentive to discharge in full and with appropriate professional care the supervisory and fidiciary duties the rule imposes upon them. In requiring restoration, we have not ignored the possible hardship it may impose upon the settling plaintiffs and the distaste it may engender in some

quarters. The Rule 23 policies we have cited, however, outweigh these factors. Moreover, it is quite apparent that the implicit remedy *Piambino I* prescribed was not strong enough; so we go one step further and make it explicit.

Second, as between the non-participating members of the Minority Group and the plaintiffs who benefitted from the settlement, the equities lie with the former. *Piambino I* made this abundantly clear, and nothing has transpired since that decision came down to alter the picture. These plaintiffs will simply have to turn to their lawyers for redress. Whether they can call upon Lead Counsel to indemnify them or otherwise make them whole is a question that is not before us, and we intimate no opinion thereon. We do not recognize, however, that it would not be far fetched for these plaintiffs to lay claims against Lead Counsel; this recognition is why, in the discussion that follows in Subpart C, we disqualify Lead Counsel from further professional participation in this case, except to represent themselves *pro se*. Before we turn to this discussion, however, we must deal with the $500,000 injunction bond the district court dissolved so that it could be treated as part of the settlement proceeds.

The parties treated the bond money as part of the settlement proceeds because, under the terms of the settlement, Bestline "waived" any claim it might have had to the money. The district court erred in approving the transfer of this money from the registry of the court, where it stood as a bond, to Lead Counsel and their clients, because Bestline's appeal from the injunction was still alive. Lead Counsel point out, in defense of the court's action, that the settlement agreement called for Bestline to abandon its appeal; thus, the bond was

not needed for its protection. This does not end the matter, however.

Rule 65(c) requires a party obtaining an injunction to post a bond "for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained." The parties "enjoined or restrained" in this case were Bestline *and* Sylva. Inexplicably, the court ordered one of the enjoined parties, Bestline, to post the applicant's bond.

Bestline did not need the bond to secure it from loss, since, except for the $500,000 placed in the court's registry, the injunction allowed it to retain monies that would have gone to the California Fund. As for the $500,000, Bestline did not need the bond;[70] that sum was as "secure" in the court's registry as it would have been in Bestline's own coffers.

The party who needed a bond was Sylva, and he needed one for a sum far in excess of $500,000. His potential loss was the amount Bestline still owed on the California Judgment. Thus, the court's dissolution of the injunction bond deprived Sylva of a source of recompense in the event the *Piambino I* panel vacated the injunction.

[13] We have not had the occasion to decide whether a party who receives the proceeds of a cash injunction bond dissolved pending appeal must redeposit them

[70]One could argue that Bestline needed the bond to cover the interest it would have earned on the $500,000 during the life of the injunction. Assuming, however, that the clerk of the court deposited the bond money in an interest bearing account, a practice ordained by the Judicial Conference of the United States, Bestline could hardly have suffered even a loss of interest.

when the injunction is vacated as improvidently granted. Other circuits have decided this question, however, holding that a prematurely dissolved bond must be redeposited. Then Tenth Circuit's rationale is persuasive. In *Atomic Oil Co. of Oklahoma v. Bardahl Oil Co.*, 419 F.2d 1097 (10th Cir.1969), *cert. denied*, 397 U.S. 1063, 90 S.Ct. 1500, 25 L.Ed.2d 685 (1970), a case, like the one here, involving the dissolution of an injunction bond pending appeal, the court noted the absolute nature of Rule 65(c)'s bond requirement: before a court may issue a preliminary injunction, a bond *must* be posted. This requirement, the court found, was intended by Congress to protect enjoined parties from the losses that result from improvidently granted injunctions. The court observed that, if it did not mandate the reposting of the bond, trial judges might pay mere lip service to both the letter and spirit of Rule 65(c). *Id.* at 1101. *See also Northeast Airlines, Inc. v. Nationwide Charters & Conventions, Inc.*, 413 F.2d 335, 338 (1st Cir.1969); *but see Buddy Systems, Inc. v. Exer-Genie, Inc.*, 545 F.2d 1164 (9th Cir.1976), *cert. denied*, 431 U.S. 903, 97 S.Ct. 1694, 52 L.Ed.2d 387 (1977).

The consequences that can flow from the premature dissolution of a Rule 65(c) bond are evident in the instant case. Unless the bond, here, is reposted, Sylva, as Compliance Officer for the California Judgment, will lose a vital remedy, the recovery of damages against the bond, the law affords a party who has been wrongfully enjoined. We therefore hold, and instruct the district court, that the first $500,000 Lead Counsel and the settling plaintiffs restore to the court's registry shall replace the dissolved bond.[71]

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[71]In reaching this conclusion, we note that Bestline makes no claim whatever to the $500,000. We thus need not decide the

C.

[14] The preceding discussion leads inexorably to the question of Lead Counsel's future role as an advocate for the plaintiffs in these proceedings. Perhaps the question is rhetorical, having been answered by Lead Counsel's professional performance in this case.

Before proceeding further, we think it important to restate some observations that have been made by lawyers and judges about class actions and, in particular, the delicate role of the class lawyer. It has been said that class actions are "strike suits promoted by attorneys who simply are seeking fat fees"[72] and that nothing has created as much "cynicism at the bar" as the settlement negotiations in class actions and the "accompanying maneuvering for fees."[73] In Chief Judge Lumbard's view, "[t]he only persons to gain from a class suit are not potential plaintiffs, but the attorneys who will represent them."[74] "When counsel for the [plaintiff-]class negotiates simultaneously for the settlement fund and for individual

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(Footnote 71 Continued)

question of whether an enjoined party (Bestline) who has been wrongfully required to post a Rule 65(c) bond for the benefit of another enjoined party (Sylva) is entitled to the return of the bond before the latter party can proceed against it.

[72]*Foster v. Boise-Cascade, Inc.*, 420 F.Supp. 674, 680 (S.D. Tex. 1976) (citing 7A C. Wright & A. Miller, Federal Practice and Procedure, §1803, at 104 (Supp. 1976)), *aff'd* 577 F.2d 335 (5th Cir. 1978).

[73]*Id.* at 680 n. 4.

[74]*Eisen v. Carlisle & Jacquelin* (Eisen II), 391 F.2d 555, 571 (2d Cir. 1968) (Lumbard, C.J., dissenting.)

counsel fees there is an inherent conflict of interest."[75] The defendant, and therefore its counsel, is "uninterested in what portion of the total payment will go to the class and what percentage will go to the class attorney;"[76] accordingly, the defense operates as no brake against the invidious effects of such a conflict of interest.

When the class attorneys succeed in reaping "a golden harvest of fees"[77] in a case involving a relatively small recovery, the judicial system and the legal profession are disparaged. As Judge Moore has observed, "[t]he practice of awarding attorneys' fees is one that has been 'delicate, embarrassing and disturbing' for the courts. (citations omitted). This embarrassment is rooted in the fact that 'the bitterest complaints [about the legal profession] from laymen [are directed at] the windfall fees and featherbedding that lawyers have managed to perpetuate through . . . their influence with the judiciary.' "[78] "For the sake of their own integrity, the integrity of the legal profession, and the integrity of Rule 23, it is important that the courts should avoid awarding 'windfall fees' and that they should likewise avoid every appearance of having done so."[79]

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[75]Manual for Complex Litigation §1.46, at 50 (Tent.Draft, 5th Rev.)

[76]*Foster v. Boise-Cascade, Inc.*, 420 F.Supp. 674, 686 (S.D. Tex. 1976), *aff'd* 577 F.2d 335 (5th Cir. 1978).

[77]*Free World Foreign Cars, Inc. v. Alfa Romeo*, 55 F.R.D. 26, 30 (S.D.N.Y. 1972).

[78]*City of Detroit v. Grinnel Corp.*, 495 F.2d 448, 469-70 (2d Cir. 1974) (citing Graham, Guest Opinion on Legal Fees: Fluffing the Golden Fleece, Juris Doctor, 10, 11 (February 1973)).

[79]*Id.*

In an effort to avoid the sort of abuse and "sharp" professional practice these quotations describe, Rule 23 imposes heavy burdens on the court and plaintiffs' counsel. In the situation before us, for example, "by asserting a representative role on behalf of the alleged class [as Lead Counsel did when they filed this suit, Lead Counsel] voluntarily accepted a fiduciary obligation towards the members of the putative class they [undertook] to represent. They [could] not abandon the fiduciary role they assumed at will or by agreement with the [defendants], if prejudice to the members of the class they claimed to represent would result or if they have improperly used the class action procedure for their personal aggrandizement."[80] Moreover, once the court below determined the class and designated Lead Counsel as the lead attorneys in this case, they commenced to serve "in something of a position of public trust.[81] Consequently, [they] share[d] with the court the burden of protecting the class action device

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[80]*Shelton v. Pargo*, 582 F.2d 1298, 1305 (4th Cir. 1978).

[81]As the Second Circuit's observation in *Alpine Pharmacy, Inc. v. Chas. Pfizer & Co., Inc.*, 481 F.2d 1045, 1050 (2d. Cir.), *cert. denied*, 414 U.S. 1092, 94 S.Ct. 722, 38 L.Ed.2d 549 (1973), amplified this point:

> "One accepting employment as counsel in a class action does not become a class representative through simple operation of the private enterprise system. Rather, both the class determination and designation of counsel as class representative come through judicial determinations, and the attorney so benefited serves in something of a position of public trust. Consequently, he shares with the court the burden of protecting the class action device against public apprehensions that it encourages strike suits and excessive attorneys' fees."

against public apprehensions that it encourages strike suits and excessive attorneys' fees."[82]

The plaintiff-class, as an entity, was not Lead Counsel's client in this case. Rather, Lead Counsel continued "to have responsibilities to each individual member of the class even when negotiating"[83] the settlement now in question. By definition, these responsibilities extended to the Minority Group.[84]

When very early in this case Lead Counsel found themselves in a conflict of interest with the Minority Group, they became, under Rule 23, " 'generally [un]able to conduct the litigation' and there [was] inadequate representation of the [Minority Group's] interest."[85] Lead Counsel certainly knew, or should have known, that "the presence of the . . . conflict would create divided loyalties which would constitute inadequate

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[82]*Alpine Pharmacy*, 481 F.2d at 1050.

[83]*Mandujano v. Basic Vegetable Products, Inc.*, 541 F.2d 832, 835 (9th Cir. 1976).

[84]These responsibilities are reflected in Canons 5 and 7 of the Code of Professional Responsibility, American Bar Association, as amended February, 1975. Canon 5 requires the lawyer to "exercise independent professional judgment on behalf of a client" and Canon 7 requires a lawyer to "represent a client zealously within the bounds of law." Ethical Considerations (EC) 5-14, 5-15, 5-16, and 5-17 caution the lawyer to refrain from representation of multiple clients having "potentially differing interests."
Mandujano v. Basic Vegetable Products, Inc., 541 F.2d at 835, n. 4.

[85]*In re Fine Paper Antitrust Litigation*, 617 F.2d 22, 27 (3d Cir. 1980) (quoting *North American Acceptance v. Arnall, Golden & Gregory*, 593 F.2d 642, 644 (5th Cir. 1979)).

representation."[86] They knew, as class-action lawyers, that

> [t]he interests of lawyer and class may diverge, as may the interest of different members of the class, and certain interests may be wrongfully compromised, betrayed, or "sold out" without drawing the attention of the court. For this reason, in addition to requiring that the trial court evaluate whether a class action settlement is "fair, adequate and reasonable and is not the product of collusion between the parties", . . . the law accords special protections, primarily procedural in nature, to individual class members whose interests may be compromised in the settlement process. These protections include notice, ensuring that class members know when their rights are being compromised, and an opportunity to voice objections to the settlement.[87]

In this case, it is beyond peradventure that the notice Lead Counsel prepared and, with court approval, sent to the Minority Group concerning the Bestline settlement, and the Bailey settlement as well, did not inform the members of that Group that their rights were being compromised, if not foreclosed altogether, and that they would have a chance to object in open court. "In such a situation, [Lead Counsel's] duty to the [Minority Group] require[d them] to point out [to the

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[86] *Id.*

[87] *Pettway v. American Cast Iron Pipe Co.*, 576 F.2d 1157, 1169 (5th Cir. 1978), *cert. denied*, 439 U.S. 1115, 99 S.Ct. 1020, 59 L.Ed.2d 74 (1979), *cert. denied*, ____ U.S. ____, 104 S.Ct. 3515, 82 L.Ed.2d 824 (1984); *cert. dismissed*, ____ U.S. ____, 104 S.Ct. 3526, 82 L.Ed.2d 833 (1984).

court their conflict with the Minority Group] so that the court [could] take appropriate steps to protect the interests of [these] absentee class members."[88]

As far as we can tell from the record, Lead Counsel have *never* confessed that they had an irreconcilable conflict of interest with the Minority Group and that they could no longer represent that segment of the plaintiff-class. Nor have they ever suggested that the Minority Group was in need of separate counsel; on the contrary, they have steadfastly argued, usually in opposition to Sylva's entreaties in behalf of the Minority Group, that these class members needed no representation other than that they were affording them. Lead Counsel have adhered to this position throughout, even when they argued to the district court, after the *Fiambino I* mandate issued, that the Minority Group should be deleted from the class because they had formally released their claims against Bestline. Bestline, itself, had not gone that far.

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[88] *Pettway v. American Cast Iron Pipe Co.*, 576 F.2d at 1176. The court below should have sensed Lead Counsel's conflict with the Minority Group, especially after Lead Counsel moved the court to enjoin the June 30, 1976 payment from Bestline to the California Fund on the ground that the Fund's distribution of restitution payments solely to the Minority Group violated the Majority Group's fourteenth amendment rights to due process and equal protection. "[T]he trial court has the continuing duty to monitor the status, as to possible conflict, of the class attorneys to assure that the class is adequately represented. *North American Acceptance v. Arnall, Golden & Gregory*, 593 F.2d 642, 645 (5th Cir. 1979). 'If at any time the trial court realizes that class counsel should be disqualified, it is required to take appropriate action.' *Id.*" *In Re Fine Paper Antitrust Litigation*, 617 F.2d at 27. Appropriate action in the instant case would have involved, at the very least, the designation of the Minority Group as a subclass with the right to have separate counsel unbeholden to Lead Counsel.

Exercising our power to supervise the district courts, we bring an end to Lead Counsel's role as class attorneys in this case. Appellate courts have invoked their "supervisory power" in a wide variety of situations. Initially, this power was used to formulate rules in criminal proceedings, which, although not constitutionally mandated, ensured fairness in the criminal process. *See e.g., McNabb v. United States*, 318 U.S. 332, 340-41, 63 S.Ct. 608, 613, 87 L.Ed. (1943). Later, the courts invoked their supervisory power to formulate rules of civil litigation. *See, e.g., Klapprott v. United States*, 335 U.S. 601, 69 S.Ct. 384, 93 L.Ed. 1099 (1949) (citizenship may not be revoked by default judgment); *Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704, 710-11 (7th Cir.1979) (court requires that trial briefs henceforth be exchanged before rather than after trial to avoid prejudicing the parties), *cert. denied*, 445 U.S. 917, 100 S.Ct. 1278, 63 L.Ed.2d 601 (1980). Despite the wide variety of situations in which supervisory power has been invoked, the objective behind its use—fashioning procedures and remedies that ensure that the judicial process remains a fair one—has not varied.

It is patently clear, as the record shows, that Lead Counsel have, from start to finish, been in diametric opposition to the interests of the Minority Group and that they cannot possibly continue to represent them. Lead Counsel are also in irretrievable conflict with the Majority Group. By today's decision, Lead Counsel will be required to pay to the registry of the district court $800,000 in fees and reimbursed expenses. As they advised us in oral argument, that money has been spent, and they do not have the resources to pay it back. Whatever course Lead Counsel choose to follow in an effort to extricate themselves from their present

dilemma, one thing is clear: if allowed to remain in this case, they would have a compelling interest in negotiating a settlement that covers their losses. Lead Counsel manifested the extent of their compelling interest in the district court, following the issuance of the *Piambino I* mandate, when they urged the court to circumvent that mandate. Thus, any settlement they might arrange would, indeed, be suspect, even if, in truth, it was "fair, adequate and reasonable." Lead Counsel's representation of the plaintiff-class in this case is therefore terminated.

III.

In summary, we hold as follows:

First, David R. Sylva, as an intervenor in behalf of the Minority Group, is a party plaintiff in this case. The district court shall recognize him as such and shall certify the Minority Group as a plaintiff-subclass upon receipt of our mandate.

Second, Lead Counsel shall pay into the registry of the district court the attorney's fee and reimbursed litigation expenses they received in connection with the Bestline settlement, with interest at the legal rate from the date of this court's issuance of the mandate in *Piambino I*. Immediately upon its receipt of our mandate, the district court shall *instanter*, without a hearing, issue an order directing Lead Counsel to deposit such amount in the court's registry within thirty days of the date of its order. The order shall recite that Lead Counsel's failure to comply therewith shall subject them to the district court's contempt power.

Third, each of the class plaintiffs who received proceeds of the Bestline settlement shall pay the total amount of such proceeds into the registry of the district court, with interest from the date the clerk of the court

disbursed such proceeds to them. Immediately upon its receipt of our mandate, the district court shall *instanter*, without a hearing, issue an order directing that each such plaintiff deposit the amount of the proceeds he received in the court's registry within thirty days of the date of its order. The order shall recite that failure of such plaintiff to comply therewith shall subject him to the district court's contempt power.

Fourth, the first $500,000 deposited in the registry of the district court pursuant to this mandate shall be set aside as a Fed.R.Civ.P. 65(c) bond, against which bond Sylva may claim damages, in behalf of those qualified to receive disbursements from the California Fund, caused by the district court's issuance of the June 30, 1976 preliminary injunction.

Fifth, with the exception of the $500,000 mentioned in paragraph fourth, the funds deposited in the registry of the district court pursuant to this mandate shall be subject to levy by Sylva in the enforcement of the California Judgment.[89]

Sixth, nothing in this decision shall be construed to preclude Sylva from pursuing the execution of the California Judgment, by writ of execution, attachment, garnishment or other procedure, against Lead Counsel or any plaintiff who received proceeds of the Bestline settlement.

Seventh, Lead Counsel are barred from appearing as counsel for any party in this case, save themselves, effective as of the date this opinion is published.

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[89]*See supra* note 66.

Eighth, on receipt of our mandate, the district court shall appoint counsel to represent the members of the plaintiff-class comprising the Majority Group, in the event such class members are unable to employ counsel.

Ninth, neither *Piambino I* nor this decision has adjudicated the lawfulness of the Bailey settlement, since no appeal has ever been taken from the district court's partial final judgment approving that settlement. We therefore intimate no opinion as to the validity thereof.

All orders of the district court, including those set forth in this opinion, which are inconsistent with this opinion are VACATED and the cause is REMANDED for further proceedings.

VACATED and REMANDED, with instructions.

[FILED MAY 15 1985]

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 82-5844

PETER PIAMBINO and
JOSEPH F. KUCKLICK,

Plaintiffs-Appellees,

versus

WILLIAM E. BAILEY,
DAIVD L. EASTIS,

Defendants,

BESTLINE PRODUCTS, INC.,
a California corp.,

Defendant-Appellee,

DAVID SYLVA,

Intervenor-Appellant.

Appeal from the United States District
Court for the Southern District of Florida

ORDER:

Appellee's motion for extension of time to 30 days after appointment of counsel for the Majority Group within which to file a petition for rehearing or a suggestion for en banc consideration is denied.

/s/ [illegible]
UNITED STATES CIRCUIT JUDGE

[FILED MAY 15 1985]

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 82-5844

PETER PIAMBINO and
JOSEPH F. KUCKLICK,

Plaintiffs-Appellees,

versus

WILLIAM E. BAILEY,
DAIVD L. EASTIS and

Defendants,

BESTLINE PRODUCTS, INC.,
a California corp.,

Defendant-Appellee,

DAVID SYLVA,

Intervenor-Appellant.

Appeal from the United States District for the
Southern District of Florida

**ON PETITIONS FOR REHEARING AND
SUGGESTION FOR REHEARING EN BANC**

(Opinion March 18, 11 Cir., 1985, ____ F.2d____).

(MAY 15 1985)

Before TJOFLAT and CLARK, Circuit Judges, and GOLDBERG*, Senior Circuit Judge.

PER CURIAM:

(✓) The Petition for Rehearing is DENIED and no member of this panel nor other Judge in regular active

service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Eleventh Circuit Rule 26), the Suggestion for Rehearing En Banc is DENIED.

( ) The Petition for Rehearing is DENIED and the Court having been polled at the request of one of the members of the Court and a majority of the Circuit Judges who are in regular active service not having voted in favor of it (Rule 35, Federal Rules of Appellate Procedure; Eleventh Circuit Rule 26), the Suggestion for Rehearing En Banc is also DENIED.

( ) A member of the Court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service not having voted in favor of it, rehearing en banc is DENIED.

ENTERED FOR THE COURT:

/s/ [illegible]

United States Circuit Judge